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BEFORE THE
DEPARTMENT OF TRANSPORTATION
WASHINGTON, D.C.

COMPUTER RESERVATIONS SYSTEM
(CRS) REGULATIONS

Supplemental Advance Notice of Proposed
Rulemaking

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)
) Docket OST-97-2881 - 144
) Docket OST-97-3014 - 13
) Docket OST-98-4775 - 59
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COMMENTS OF ORBITZ, L.L.C.

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September 22, 2000

COMMENTS OF ORBITZ, L.L.C.

These comments are submitted on behalf of Orbitz, L.L.C. Orbitz is an Internet start-up company that plans to bring new competition to online travel sales by creating a website that will provide consumers with comprehensive and unbiased travel information. In these comments, Orbitz will explain how the Department can best ensure that the CRS Rules serve their intended purpose of protecting consumers and competition, how Orbitz will play a major role in restoring competition to the airline ticket distribution industry, and how premature regulation of Orbitz and other online agents would cripple Orbitz and the Internet's pro-competitive potential.

Summary of Comments

Although these comments necessarily address a number of complex policy and factual issues, the position of Orbitz boils down to this:

- Part 255 has not adequately restrained the exercise of market power by the CRSs, resulting in stagnant innovation and high airfare distribution costs; and
- Internet travel sites that are independent from CRSs represent one solution to the market power of the CRSs. Therefore, Internet travel sales should not be regulated, either through the wholesale extension of Part 255 to such sales or through the adoption of Internet-specific content regulation.

A fair amount of background is required to appreciate the basis for Orbitz's position.

A. Background.

1. The playing field and the players.

The success of Internet retailing rests on the foundation of the sale of travel. Travel is the single largest product or service sold on the Internet. Forrester Research, an Internet research firm, estimates that in 2001 Internet travel sales will reach \$20 billion.

As with many other computer applications, the sale of travel on the Internet lends itself to the "first in - last in" phenomenon, i.e., one or two large firms enter the market, establish market power and then try to exclude other firms from entering. In the Internet travel sales market, the "first in" were the largest of all possible entrants – Sabre (through Travelocity) and Microsoft (through Expedia). Today, Sabre, leveraging its monopoly rents from the CRS market, and Microsoft, true to its reputation, have a duopoly in online agency sales:

- 70% of all Internet travel sales on multiple airline display sites are made through Travelocity or Expedia; and
- Through exclusive deals with the largest Internet portals – including AOL, Yahoo and MSN – Travelocity and Expedia have locked-up exclusive arrangements with the portals used by 90% of all users of the Internet.

The CRS industry is only slightly better from a competitive standpoint – in effect, an oligopoly rather than a duopoly. Sabre alone, however, controls 46% of all CRS bookings in the United States. And nonetheless, CRS vendors can charge monopoly rent booking fees because each CRS is essential to each airline's retail distribution system.

Orbitz is a competitive response to the Sabre-Microsoft duopoly in Internet travel sales and to the oligopoly of CRS vendors. Orbitz first was invested in by airlines – although the interest of the initial investors will quickly and substantially be diluted as Orbitz grows – to lower distribution costs by bringing competitive pressure to CRS booking fees, offer unbiased displays of flights, and allow individual airlines to control of their own marketing and booking data. The business model is straightforward: give consumers what they want – complete and unbiased information on their air travel options, while lowering the CRS booking fee component of airline distribution costs.

Orbitz can do that, for two reasons. First, Orbitz has invested in the technology which is more efficient and which can search and display every travel option in a city-pair market. Orbitz's willingness to invest in superior search and display technology will almost always be the reason that Orbitz can show a consumer a lower fare than can a CRS-based system. Second, Orbitz has the business incentive to do so. The best possible information is what Orbitz will sell,

is contractually bound to sell, and must sell if Orbitz is to have any chance of attracting consumers away from the two dominant, biased websites. The consumer – not Sabre, Microsoft, or another CRS vendor – will control the information.

The “hot button” issue for Orbitz has been the allegation that it will limit the availability of fares by selling fares that are not available through travel agents. That argument gets the facts backwards. Orbitz will expand and assure the public availability of fares.

Today, airlines offer fares through a wide variety of distribution channels. It is generally understood in the travel industry that over 99% of all published fares are available through all channels. However, some fares are available only through direct purchase on the carrier’s own web sites. Other fares are available only through Internet-based travel agents such as Travelocity and Expedia. Against this background, Orbitz requires that any fare offered by a participating carrier to the general public through any other distribution channel must also be made available to the public through Orbitz. It is a requirement that expands, not contracts, the availability of fares.

Moreover, participating carriers are free to offer, through any other distribution channel, any fare offered through Orbitz. Again, the intent and effect is to expand, not contract, the public availability of fares. A participating carrier could offer a fare exclusively through Orbitz if it so chose, just as carriers presently do on a limited basis through traditional travel agents, through their own websites and through Travelocity and Expedia. But that is a choice that each carrier is free to make – and a choice that they are unlikely to make, as a matter of economic logic. Aviation is a narrow margin business, and airlines must sell tickets through all profitable channels, even though some may be slightly more profitable than others. Once a carrier becomes

a participant in Orbitz, however, the public will at least be assured that most of its fares (again, excluding fares not offered to the general public) at least will be available on more than one site.

2. *The CRS Rules.*

The CRS Rules have to be measured against the goals of protecting consumers and protecting competition. Specifically, the rules primarily were aimed at four marketplace abuses: display bias; excessive booking fees charged to airlines; contracts that abused travel agents; and unequal access to CRS marketing and booking data. The record suggests that the rules have been only a limited success:

<u>Abuse</u>	<u>Part 255 Grade</u>	<u>Comments</u>
1. Display bias.	FAIR	Part 255.4 is written with 1960's technology as the norm. New technology makes the rule an underachiever in terms of reducing bias.
2. Excessive booking fees.	POOR	The failure to address the reasonableness of booking fees has permitted entrenched CRS vendors to impose monopoly rents on their airline customers.
3. Abusive contracts with travel agents.	POOR	Part 255.8 prohibited a few of the abusive practices CRSs imposed on agents, but left more than enough for CRSs to continue to deprive agents of market choice.
4. Marketing and booking data issues.	FAIR	Part 255.10 is meant to address the problem, but some smaller carriers allege that they are still prejudiced.

There also is the glaring problem of coverage. As written, the CRS rules arguably do not apply to Sabre, the dominant CRS vendor, because it is no longer airline-owned. All of this is by

way of suggesting that, the Internet aside, the Department has good reason to repair the existing rules.

B. Internet air travel sales should be spared from economic regulation.

1. Do not extend the CRS Rules to Internet sales.

Regulating Internet content is a dicey proposition, at best. Regulating Internet content through a scheme that has not worked particularly well in the CRS arena for which it was originally intended – exclusively business-to-business transactions – is even riskier.

Putting aside the anomaly that Sabre arguably is not covered (and Travelocity definitely is not covered) by the rules that Sabre/Travelocity seeks to have extended to others, Part 255 is unnecessary in the context of a world where consumers are free to switch instantly to better sources of information. In a free and open market there certainly should be, by definition, no need for a display bias rule. (But if the display bias rule were to be extended by the Department to Internet travel sales sites, it logically should be extended to all online agents and CRS web interfaces, without regard to their ownership of each site.)

In addition, the mandatory participation rule – a rule intended to make fare and other information more widely available – could in fact make them less available in the Internet context by requiring that sites be “dumbed down” to the lowest common denominator. Other CRS rules assume business and/or marketing relationships that are peculiar to traditional travel agents. In sum, there is no reason to extend the Department’s economic regulation of airline ticket sales through Part 255 to Internet sales, and compelling reasons to be wary of doing so.

When Part 255 was first promulgated, there was a substantial administrative record, based on the CAB’s experience with the existing CRSs, that demonstrated both the reality of and

potential for consumer deception and unfair competition, based on the existing substantial market power of the CRSs. In particular, the rulemaking record strongly established that travel agents could not in most instances effectively switch systems; that airlines could only reach customers through the CRSs which had under contract the agents used by those customers; and that airlines therefore had no normal market negotiating influence over CRS behavior such as on booking fees, display bias, data practices, etc. This record was the foundation for the CAB's conclusion that many CRS practices were at least contrary to antitrust principles, if not directly in violation of antitrust laws.

Nonetheless, the regulation barely survived judicial review. Writing for the court, Judge Posner noted that the CAB's analysis and conclusions, although not necessarily arbitrary and capricious, were "far from airtight," and that "if we thought ourselves free to do so we might hold that the Board had used rulemaking procedures to make adjudicative factfindings." United Air Lines, Inc. v. CAB, 766 F.2d 1107, 1113, 1118 (7th Cir. 1985). The close call was resolved in favor of Part 255 because of precedent giving an agency substantial – but not unlimited – deference in industry-wide rulemaking. See id. at 1119-20.

The outcome would not necessarily be the same if the Department decided to extend Part 255 to the Internet. Although the Internet, in practice, has not – yet – been a perfect market for the sale of air travel, there is no evidence that Internet consumers, unlike travel agents, cannot – much less will not – switch immediately to another source of information as soon as it is available, or that the dominant online agencies are competitively unassailable (as the CRSs long have been). Therefore, there is no basis to conclude that any special content or display regulation is necessary on the Internet. However, as for many deregulated marketplaces, rigorous antitrust enforcement is central to maintaining competition and consumer choice

through new entry. Accordingly, barriers to new entry such as exclusive, multi-year agreements with major Internet portals and heavy-handed lobbying efforts designed to ward off rivals are practices that deserve careful scrutiny.

Internet joint ventures designed to lower distribution costs should not be exempt from review. However, properly structured, such ventures can achieve pro-competitive efficiencies without anti-competitive harm. The Federal Trade Commission recently touched on this issue when it approved the creation of Covisint, a business-to-business joint venture directed at product design, supply chain management, and procurement in the automobile industry.

Covisint's partners include companies accounting for 50% of world automobile production.

FTC Chairman Robert Pitofsky stated that:

[E]lectronic marketplaces offer great promise as means through which significant cost savings can be achieved, business processes can be more efficiently organized, and competition may be enhanced. B2Bs have a great potential to benefit both businesses and consumers through increased productivity and lower prices.

FTC Terminates HSR Waiting Period for Covisint B2B Venture, FTC News Release, Sept. 11, 2000.

2. *Do not adopt any Internet-specific regulatory proposals.*

Some parties have suggested that even if the Department does not extend Part 255 itself to the Internet, other special requirements should be imposed on Internet ticket sales – for example, that airlines should be required to offer all channels any deals they offer Orbitz. In other words, Orbitz would become the DOT-mandated template for Internet travel sales. The suggestion is flattering, but it also is impractical and could be costly to consumers. It necessarily would involve such a heavy degree of Federal regulation as to be unworkable.

3. *Repair the existing CRS Rules.*

Although the Internet holds promise for improving part of the overall airline distribution chain, the CRSs are likely to remain significant in that chain. Therefore, where the existing CRS Rules have failed, they should be strengthened. There are a number of ways that the CRS rules can be fixed to better protect consumers and competition, including:

- Applying the rules to all CRSs that contract with travel agents without regard to airline ownership, i.e., making it clear that Sabre is included;
- Giving travel agents more competitive choices by such actions as reducing the maximum term for contracts, prohibiting liquidated damages clauses, and prohibiting unreasonable limits on the use of third-party hardware and software; and
- Having strengthened the CRS Rules, extending them for at least another five years.

C. The bottom line.

The most important legal consideration in this matter is the law of unintended consequences. The Department did not intend that the CRS regulations would entrench the CRS oligopoly. The Department did not intend that the CRS vendors would be able to raise booking fees to the point where they became a disincentive for airlines to book through travel agents. And the Department certainly did not intend that the CRS rules arguably would fail to cover the largest CRS vendor. Yet all of those things happened.

Orbitz's bottom line is this: Do not let the law of unintended consequences work its way to Internet-based information distribution systems that promise to drive the CRS vendors and the dominant online agents to more competitive performance. There is little to gain and everything to lose if the Department decided to get into the business of regulating Internet content.

Comments

I. A FULL AND COMPLETE UNDERSTANDING OF THE FACTUAL BACKGROUND OF THE CRS RULES IS REQUIRED BEFORE UNDERTAKING ANY REGULATORY ANALYSIS.

A. The CRS Rules have not realized their intended goals of protecting consumers and protecting competition.

The CRS Rules originally were promulgated in 1984, and revised in 1992, with the intended purpose of protecting the interests of consumers and competition in the travel industry. In some respects, the CRS Rules have been successful. However, as almost every party that has filed comments in this proceeding has acknowledged, in other respects they have not. Indeed, not only have many of the rules been inadequate; some have inadvertently harmed consumers and competition. The Department only will be able to make Part 255 effective for the 21st century if it understands the reasons why the CRS Rules were, and were not, effective in the past century.

The CRS Rules have limited some of the most visible and egregious abuses of the CRSs. But they have done little about the underlying market power of the CRSs, which depends on their tight contractual hold over their travel agent subscribers, as well as the inability of airlines to effectively bargain with CRSs over fees, displays, or other terms and conditions. The inevitable result, as described in the Department's May 1988 Study of Airline Computer Reservations Systems, as well as in subsequent Department and GAO studies, has been the perpetuation and institutionalization of CRS market power. Because the CRS Rules attempted merely to limit the most extreme behavior of the CRS oligopolists, and not to correct the market power problem itself, the CRSs have been able to simply adapt to the slight changes that the CRS Rules required in 1984 and 1992.

The CRS Rules in fact have come to serve in many ways as a protective shield for the CRS oligopoly – the CRSs operate in a cozy environment in which the rules of the road are well known, there are no surprises to rock the boat, and the status quo is perpetuated. In its review of the CRS Rules, the Department must be willing to confront the serious problems Part 255 unintentionally helped to create. It must not simply rearrange the metaphorical deck chairs on the Titanic, as it did in 1992. The CRS Rules should not simply be re-adopted. Where CRSs continue to have the ability to deny agents ongoing choice among CRSs and to dictate booking fees, display practices, and other terms and conditions to airlines without normal two-way market negotiations, the CRS Rules should be strengthened to correct the resulting abuses and market distortions. And where the prospect of competition and new technology exists – as in the case of Orbitz – the Department should be wary of proposals by entrenched incumbents designed to prevent that new competition and innovation from occurring. It is of critical importance that the CRS Rules be strengthened and closely focused on the task of remedying the market power of the CRSs, and thereby serve the interests of consumers, agents, and airline competition. As Kenneth M. Mead, the Department's Inspector General, has explained in written testimony to Congress:

Changing marketplace and technological developments raise serious concerns about the sufficiency and relevance of current CRS regulations. The current regulations are designed to promote competition and to protect the consumer from unfair and deceptive practices, but the new state of information accessibility poses some difficult questions concerning what protections are needed in the modern marketplace. Confusion exists over whether these regulations apply in the current market, to whom they apply, and how.

Statement of the Honorable Kenneth M. Mead, Inspector General, U.S. Department of Transportation, before the Committee on Commerce, Science and Transportation, U.S. Senate, July 20, 2000, at 24-25.

1. The CRS Rules were enacted in response to serious existing anti-competitive problems in the travel industry.

The CRS Rules were enacted in 1984 in response to serious anti-competitive problems that already existed in the travel industry. The Civil Aeronautics Board and the Justice Department had found that the CRSs possessed substantial market power over airlines and travel agents, and that the CRSs exercised their market power to the detriment of consumers, agents, and competition. The four most serious problems were:

a. Display bias.

When a travel agent requests flight information from a CRS, the CRS ranks the available flights before they are displayed. Prior to the CRS Rules, CRSs would give priority to the flights operated by their airline owners, or by other airlines that had paid the CRSs for display bias. Display bias denied travel agents, and ultimately consumers, easy access to information about the most convenient and least expensive flights.

b. Excessive booking fees.

For each flight segment booked through a CRS, the CRS charges the airline a booking fee. Prior to the CRS Rules, CRSs would charge different booking fees to different airlines. The fees also were excessive as well as discriminatory.

c. Abusive contracts with travel agents.

By the early 1980s, travel agents had little choice but to use a CRS, if they were to remain competitive. Moreover, each CRS attempted to make it virtually impossible for an agent, once it had subscribed to that CRS, to switch to another. CRSs locked their agents into long-term contracts. Even if they did not directly prohibit the use of another CRS, they made it all but

impossible through such tactics as minimum-use clauses. Some contracts bordered on the unconscionable by including liquidated damages clauses that imposed enormous penalties on agents that switched to another CRS before the end of the contract term.

d. Marketing and booking data.

The sales data generated by travel agents using a CRS is sold by the CRS to airlines. Airlines can use this data to analyze the performance of their business, as well as that of competing airlines. Prior to the CRS Rules, the airlines that owned a CRS had exclusive access to that data. While they could use that data for marketing purposes, other airlines could not.

Every one of these problems was ultimately rooted in the tight grasp in which each CRS held its travel agents. A handful of CRSs had consolidated their control over the industry by 1982. These types of market distortions would not have occurred if there had been real competition in the CRS industry. In a free and open market, the CRSs would have competed to offer the most complete and accurate information at the lowest prices, in order to attract travel agents as well as airlines to participate in their systems. The agents and airlines, in turn, would then have been able to negotiate for the best possible terms for their participation in each CRS. But the CRS market never experienced true competition because of the early consolidation of power by a handful of CRSs. As a result, travel agents for all practical purposes had no ongoing market choice among systems, and the CRSs were able to dictate terms of participation for travel agents on a take-it-or-leave-it basis. Furthermore, the airlines – especially those that did not have an interest in a CRS – quickly discovered that they, too, had little leverage in dealing with CRSs. Because each CRS had a 100% share of its own locked-in agents, and because no airline could afford not to make its flights available for sale through agents, CRSs also dictated the

terms of participation for airlines on a largely take-it-or-leave-it basis. In sum, because neither agents nor airlines had any practical ability to bargain with the CRSs, market forces could not, acting alone, correct all of the gross distortions that the CRSs had introduced into the travel industry.

2. *The CRS Rules have produced some benefits for consumers and competition.*

In 1984, the Civil Aeronautics Board adopted the CRS Rules, and they were readopted, with mostly minor modifications, by the Department in 1992. The CRS Rules have eliminated some of the worst examples of misconduct and abuse of market power by the CRSs, but they have not diminished the CRS market power itself, nor have they prevented that market power from manifesting itself in a variety of ways, some old and some new:

a. Display bias.

The display bias rule, Part 255.4, prohibits CRSs from using search and display algorithms that use airline-specific factors to select and prioritize flights for display. However, other kinds of direct and indirect display bias are not prohibited, and in fact the severe limitations of CRS search capability are expressly accommodated by the rule.

b. Abusive contracts with travel agents.

The subscriber contracts rule, Part 255.8, prohibits CRSs from requiring travel agents to enter into contracts that run for more than five years, or from imposing a minimum use requirement on agents. However, the rules never implemented the full range of measures, including shorter contract terms and a prohibition on liquidated damages clauses, that would have led to the introduction of at least some ongoing market choice for travel agents.

c. Marketing and booking data.

The marketing and booking data rule, Part 255.10, requires CRSs to make marketing and booking data generated by their systems available to all participating carriers on nondiscriminatory terms. However, allegations have now been made by smaller carriers that the rule, in practice, still operates to their detriment.

3. *The CRS Rules have failed to address some core problems for consumers and competition, and in some respects even have made the problems worse.*

Not only have the CRS Rules failed to address some core problems for consumers and competition, but in some respects they even have made existing problems worse. Some of the CRS Rules, although well-intentioned, have crossed over to the dark side, and are in need of urgent revision.

a. Booking fees.

The CRS Rules exacerbated and institutionalized the core problem of excessive booking fees, instead of solving it. The participating carrier contracts rule, Part 255.6, has since 1984 required that the booking fees charged by CRSs be nondiscriminatory among airlines. But the Department never has adopted a rule that requires that CRS booking fees be reasonable.

The CRSs need not engage in price competition in order to attract airline participation. Every airline must participate in every CRS in order to reach the customers who use the travel agents who are contractually bound to each CRS. That was, in fact, the cause of the anti-competitive problem that the CRS Rules were created to address. But by failing to address the core problem of fee reasonableness, the rules were fated to be ineffective. CRS booking fees,

declared unreasonable and excessive by the CAB and the Justice Department in 1983, have skyrocketed since then under the CRS Rules.

Since 1983, CRS booking fees have risen by approximately 1400%. Computing costs in our economy, in general, have declined by over 99% in the same time period. Even recognizing that computing costs are not the only element of CRS booking fees, it is clear that this problem is not getting any better, and may be getting worse. In this proceeding, carriers have alleged that in the 1990s CRS booking fees increased at double the rate of the Consumer Price Index, as well as above that of the Information Processing Equipment Index, which actually declined 41% between 1992 and 1997 alone. See, e.g., Reply Comments of America West Airlines, at 19 (Feb. 3, 1998); Comments of Alaska Airlines, at 3 (Dec. 23, 1997).

The Department's May 1988 Study of Airline Computer Reservations Systems found that, despite Part 255, CRSs still were making excessive profits. During the 1989-92 rulemaking, many parties argued that the Department should revise Part 255 to limit CRS booking fees (and the Justice Department argued that booking fees should be eliminated altogether). But the Department did not act, and in the continuing absence of market competition CRS booking fees have continued to spiral upwards.

Not only have travel agents and consumers – who ultimately pay these fees – suffered as a result, but so have the airlines. In particular, excessive booking fees are a disproportionate burden for low-fare airlines. Even though these airlines pay the same fee per segment as larger airlines, that fee comprises a far larger percentage of their costs and ticket prices. And that in turn disproportionately burdens the most price-sensitive consumers, their target audience. For example, a typical booking fee is nearly \$4 per segment. Thus, on a typical one-stop connecting

round trip, the total booking fee is around \$15. For a deep discount fare, that could amount to more than 10% of the cost to the consumer.

Nor is there any prospect that CRSs will begin competing on the price of their booking fees, in the absence of any new market competition. There is no incentive to compete, because every airline must participate in every CRS, regardless of the booking fees they charge. If one CRS unilaterally were to reduce its fees, the reduction would have no effect on the booking fees the other CRSs charge participating airlines. Moreover, lower fees could not attract any additional business from travel agents, because they are still largely locked-in to contracts that prevent them from switching CRSs in the short or even the long term. Instead of competing, the CRSs tend to track each other's booking fee price increases, usually following the lead of Sabre, the largest CRS in the world. This is not prohibited collusion, but simply the predictable behavior of businesses operating under oligopolistic conditions – a distorted market that the provisions of the CRS Rules inadvertently have helped to sustain.

b. Mandatory participation.

Similarly, the mandatory participation rule, Part 255.7, which requires system owners to participate in other CRSs to the same extent that they participate in their own system, has had unanticipated consequences that have harmed consumers and competition. The rule originally was intended to prevent airlines that owned CRSs from handicapping the marketing efforts of other CRSs by refusing to participate in enhancements in the other systems. The rule perhaps has been successful in that specific objective, although there is reason to question whether the problem was more a theoretical than a concrete one. But the rule also has barred any slight potential there may still have been for price competition among CRSs. Because most major

airlines historically have been system owners as defined by Part 255.3 (Southwest being the only notable exception), they have no practical choice but to participate at the same level in all CRSs.

The rule simply has reinforced the fact that the airlines are captives of the CRSs, and are, in effect, required to participate in every enhancement that the CRSs introduce. Under these conditions it would be economically irrational for CRSs not to match every price increase associated with an enhancement introduced by another CRS. No benefit would be forthcoming to a CRS that did not so match. The rule seals the fact that none of the affected airlines can achieve any market negotiation with a CRS by threatening to withdraw in whole or in part. This is a perverse result for a rule intended to protect consumers and competition in the travel industry. While it was unlikely that any airline ever could have credibly threatened to completely withdraw from a CRS in order to mutually negotiate the terms and conditions of its participation (e.g., booking fees, unbiased displays, etc.), the mandatory participation rule has taken away even that limited possibility for negotiation from most airlines. In other words, not only did the CRS Rules fail to remedy the problem of excessive booking fees, they served to perpetuate them.

c. Travel agent contract provisions.

Although Part 255.8 has prohibited the worst symptoms of CRS exploitation of travel agents, the rule has failed to address the root cause of the problem. Because the CRSs continue to have market power over agents, the CRSs still deny agents any ongoing market choice. In 1989, the American Society of Travel Agents (“ASTA”) and many other parties filed comments that urged the DOT to adopt reforms that, in the absence of market competition, were the next-

best option to protect consumers and competition. Unfortunately, very few of them were adopted by the Department, and the CRS abuse of travel agents has continued unabated.

i. Liquidated damages clauses.

Since before the CRS Rules were proposed, and especially since the courts upheld them in the late 1980s, liquidated damages clauses have been a key anti-competitive weapon in the CRS arsenal. Agents cannot switch to another CRS before the end of their contract without paying massive damages to their current CRS. Moreover, even if these clauses accurately reflect the income a CRS could expect to earn over the remainder of the agent's contract, those expectations are grossly inflated by the market power that the CRSs now enjoy. Whatever the rationale for these clauses, their real purpose and effect is to deny agents choice, and if agents had more choice they would quite likely be better treated and better compensated by their existing CRS.

ii. Contract terms and "shingling."

In 1984, the DOT set a five-year upper limit on contracts between CRSs and travel agents. A five-year term has, as a result, become the default length for all such contracts. Even though CRSs also must offer agents a three-year contract, there is no requirement that its terms be reasonable. The provision has been rendered into a sham by the CRSs; three-year terms are only offered on a basis designed to be unacceptable to agents. Further, there is no prohibition on "shingling" – separate, overlapping (i.e., non-concurrent) five-year terms for each piece of hardware supplied by a CRS. Many agents are, therefore, in all but name locked-in to lifetime bondage contracts with their CRS. Until agents have the effective ability to switch CRSs, the problems which prompted the CRS Rules will remain essentially untouched, CRSs will have no

incentive to be competitive, and agents will not receive from CRSs their full share of the value of each transaction they book.

iii. Non-exclusivity.

The anti-tying rule prohibits a CRS from requiring that its agents use only that CRS, either directly or through a minimum use clause. However, the rule has not been sufficient to protect most agents from the market power of the CRSs. The use of multiple CRSs still is not practical for all but the largest travel agents. In addition, although productivity pricing can be a rational means by which to encourage efficiency and lower user fees for agents, it frequently has been misused by CRSs. By setting a threshold with no economic basis and that in practice requires an agent to use only a single CRS, it can achieve the same result as a minimum use clause.

The CRS Rules have made it no easier for travel agents to switch CRSs than they could before the rules were instituted in 1984. The CRSs easily have been able to perpetuate their lock on agents through the many means left open to them, including liquidated damages clauses, long-term and “shingled” contracts, and abusive forms of productivity pricing. Thus, the ultimate problem at the root of all other anti-competitive concerns about CRSs remains as much a problem after 15-plus years of the CRS Rules as it did before the rules existed.

iv. Third-party equipment.

The third-party software and hardware rule largely has been ineffective because it does not apply to terminals supplied by the CRSs. The CRSs reportedly offer sweetheart deals for computer equipment to their agents that all but nullify this rule. Moreover, this rule allows CRSs to market software to compete with third-party booking tools. The CRSs have taken this

opportunity to circumvent the display bias rule by all but giving away programs that run on top of CRSs and restore the practices that Part 255.4 prohibits.

d. Display bias.

While Part 255.4 has banished the worst and most visible abuses of CRS displays, the rule has left available many other forms of bias, which the CRSs have exploited. As described above, the third-party equipment rule allows CRSs to openly market biased booking tools which are in conflict with the spirit of the display bias rule. Many allege that CRSs still bias their displays in favor of some carriers by delaying or inaccurately entering other carriers' flight and route data, as well as by using criteria that are seemingly objective but in fact serve to advantage some airlines at the expense of others. See Comments of Frontier Airlines, at 4 (Nov. 24, 1997), citing Lawrence Sullivan, Anticipating Antitrust's Centennial: The Viability of the Current Law on Horizontal Restraints, 75 Calif. L. Rev. 835, 883 (1987).

Moreover, the display bias rule has not been updated to address a core problem of CRS displays, which is the technological limit on searches. The CRS Rules continue to tolerate the limitations of the 1960s-vintage technology used by the CRSs. The CRSs use connection tables to prescreen out over 99% of the connecting flights between City A and City B before they search based on fare and time. Most of these options that the CRSs eliminate are not good choices for the consumer. But among the options they eliminate before searching usually are some great choices – an alternate connecting city, a competing airline, a lower fare. Connection tables may have been justifiable, if just barely, by the limitations of technology a decade ago, but there is no reason for them today. Yet, because there is no market competition among CRSs, they are entirely unwilling to invest in new technology to improve their search and display

functions beyond the minimal requirements of the display bias rule. Innovation has been stifled, and agents, consumers, and competition itself have been disadvantaged by the absence of any competitive or regulatory prod to these systems to modernize their search technology, and to improve the quality of the information they display.

e. Marketing and booking data.

The marketing and booking data rule, Part 255.10, promised that airlines that owned CRSs would not be able to analyze and utilize data to which no other airline had access. The data that a CRS collects about travel purchased through its system can help an airline to analyze how to make the best use of its own resources, such as its aircraft, routes, and marketing. “In the long run this information reduces costs, improves profitability and presumably could lead to lower fares in a competitive market.” Reply Comments of Aloha Airlines, et al., at 2 (Feb. 3, 1998).

But the allegation often heard today is that this rule has not always prevented the data from being used anti-competitively, and that an equal-access-to-information rule is no guarantee that the information will, as a practical matter, be available to all airlines. Smaller and low-fare carriers allege that the CRSs often set a high price for their marketing and booking data, which these carriers cannot easily afford on top of the excessive booking fees that they already pay. See id. at 9. Moreover, these smaller and low-fare airlines allege that they are often the targets for the anti-competitive use of the data. See, e.g., Comments of Midwest Express Airlines, at 28 (Dec. 9, 1997); Comments of the Air Carrier Association of America, at 4-6 (Aug. 25, 2000).

f. Uncertain applicability to a major part of the CRS industry.

The most glaring sign that something has gone seriously wrong with the CRS Rules is that the rules arguably no longer apply to the largest CRS in the world – Sabre.¹

The CRS Rules only apply to CRSs that are owned, controlled, operated, or marketed by an airline. See Part 255.2. This airline ownership provision is a product of the time at which the CRS Rules were drafted and last revised. In 1984, there was only one CRS not owned by an airline, the struggling MARS Plus, which failed shortly thereafter. In the 1990s, the Department declined to expand the scope of the CRS Rules to systems not owned by airlines for the simple reason that there were none at the time: “[n]o non-airline systems now operate in the United States, and ... none appears likely to enter the CRS business in the near future.” Computer Reservation System (CRS) Regulations, Notice of Proposed Rulemaking, 56 Fed. Reg. 12586, 12604 (Mar. 26, 1991).

Much has changed in the past decade. Three of the four CRSs now have at least some public ownership, and Sabre has no airline ownership at all. The question of whether the world’s largest CRS is covered by the CRS Rules now hangs by the thin thread of whether Sabre still is “marketed” by its former owner, American. Sabre’s position on this question recently has changed. A few months ago, off the public record, Sabre took the position that it was no longer covered by Part 255, but that it chose for the time being to comply on a voluntary basis. More recently, Sabre has re-evaluated what being covered by Part 255 means for it, and of late it has

¹ Moreover, Galileo, the second-largest CRS, is now 75% owned by public shareholders. United, which owns 17% of Galileo, has argued in this proceeding that if Galileo is not already free of the restraints of Part 255, then it should be, based on United’s limited share thereof. See Supplemental Comments of United Airlines, Oct. 7, 1999, at 5 n.5.

taken the position that it is covered by Part 255.² This certainly is not a question that the Department should leave to speculation.

In 1997, when it began this rulemaking proceeding, the Department recognized that its previous assumptions about CRSs were no longer valid. See Computer Reservation System (CRS) Regulations, Advance Notice of Proposed Rulemaking, 62 Fed. Reg. 47606, 47607 (Nov. 3, 1997). However, the fact that today's CRSs no longer are all directly controlled by airlines has not changed the fact that these CRSs have the power and the incentive to create biased displays, to charge excessive booking fees, to hold travel agents captive, and to control access to marketing and booking data in ways that are not necessarily beneficial for airline competition.

Contracts which bind travel agents are the foundation of CRS market power, whether or not a given CRS is owned by an airline. In the past, all CRSs were airline-owned, so that the CRSs' market power manifested itself in ways that benefited airline owners. But take away airline ownership, leave the market power, and that market power will simply manifest itself in other ways. For example, the incentive to bias displays exists whether an airline owns the CRS in whole, in part, or not at all. Bias is a valuable commodity. That value can be granted to an airline owner, or it can be sold on the open market to other airlines (which is what Sabre's Travelocity does today). Either way, it can be in a CRS's economic interest to bias displays, whether or not it is owned by an airline. Furthermore, the incentive to charge excessive fees remains whoever owns the CRS. Such an incentive is the result of market power, not ownership.

It should be unacceptable that Sabre, the largest CRS in the world and the means through which almost half of all air travel is booked in the U.S., could argue at some point that it is no

² The Department should not take it as a good sign that the largest monopolist the CRS Rules were intended to restrict has decided, after careful review, that those rules offer that monopolist more protection than limitations.

longer subject to any restrictions on display bias, contracts with travel agents, and similar provisions. All CRSs that enter into contracts with travel agents unquestionably should be subject to Part 255. Such contracts are the defining basis of CRS market power, and should define the coverage of the CRS Rules as well.

B. The two dominant Internet travel sellers and their powerful parents seek to preclude effective competition in such sales.

The Internet environment has fundamentally different attributes than the old world of the CRSs. The CRSs offered travel agents a highly filtered view of the world. Agents were limited to the basic data provided by their CRS, and, as a practical matter, had no opportunity to use any other source of information. Only the most skilled and determined agents – much less consumers – consistently could locate the most convenient and least costly travel options. But the CRSs were well-served. The service they offered was less than satisfactory, but the monopoly rents they received for those services were more than satisfactory to them.

That old regime now faces, for the first time, new competition. The Internet allows agents and consumers to obtain information about travel from multiple sources, and to easily comparison shop for the best routes and fares. The Internet lacks the key problem which allowed the CRSs to entrench their anti-competitive practices in the travel industry. The CRS industry had its users, the travel agents, locked-in to highly restrictive, long-term contracts that effectively denied most of them any opportunity to switch to another CRS or to even use another CRS. But the Internet is not like that. The users of the Internet are not under contract. Any user can switch from one website to another at the click of a mouse. The Internet is, in fact, as close to a system of perfect continuing free choice for its users as any system ever devised.

But the CRSs are trying to find ways to re-create their dominance of the travel industry on and through the Internet.

Two well-known companies have moved in and established a very potent duopoly in Internet travel, and have done so with CRS-based Internet sites. One is Travelocity, the Internet arm of Sabre, which by itself controls 46% of all CRS bookings in the U.S. The other is Expedia, the Internet arm of Microsoft, the dominant computer operating system provider in the world. Neither Sabre nor Microsoft has a record of being shy about establishing market dominance and exercising that dominance aggressively. Between them they have wrapped up, through exclusive deals and mergers, 70% of all sales of tickets from online agency sites offering schedule and fare displays.

Furthermore, Sabre's Travelocity and Microsoft's Expedia have entered into long-term deals with the largest Internet portals, including AOL, Yahoo, and MSN, which gives them an exclusive position on the portals used by 90% of all Internet users. See Exhibit A. These deals are extraordinarily powerful barriers to competition. The established players clearly have no interest in leveling the playing field for new entrants.

Sabre also has been using the massive profits from its excessive CRS booking fees to, in effect, buy the Internet – and to block Orbitz and the only technology that could meaningfully compete with Sabre and other CRSs. Earlier this year, Travelocity absorbed Preview Travel, which formerly was one of its leading competitors. One of the most important assets Travelocity acquired was Preview Travel's "attractive relationships" with AOL, Excite, and other Internet portals: now, all "the top portals in fact are affiliated with the top online agencies." Timothy J. Mullaney, Q&A with James McQuivey, Business Week Online, July 27, 1999, available at <<http://www.businessweek.com/ebiz/9907/727mcquivey.htm>>. And just last month, Sabre

announced the purchase of GetThere, Inc., a major business-to-business travel services company, which provides the underlying technology for the websites of such carriers as America West, Northwest, TWA, and United. See Sabre to Acquire GetThere; Creates Leading E-Commerce Travel Platform for Corporations and Suppliers, Sabre News Release, Aug. 28, 2000. Having purchased its largest competitors, locked up the major portals, and extended its tentacles into all areas of e-commerce, Travelocity, in particular (and Expedia to a lesser degree) is sitting all but unchallenged on top of a distribution sector that is expected to quadruple over the next four years. In fact, Travelocity now boasts that it is the world's third-largest website, with more visits than any other site on the Internet except for Amazon.com and eBay.

The two dominant Internet players understand that new competition will challenge their dominance, and they don't like that possibility. Therefore, Sabre is now trying to convince Congress and the Department to block the one possibility of competition that will benefit consumers and usher in new competition: Orbitz. They may couch their arguments in terms of protecting consumers and competition, but their true motives are quite transparent. "Current CRS's, with dedicated networks, are based upon 1960's technology, and have substantially higher costs than would new systems based on Internet technology. The claim of the CRS's that there should be a 'level playing field' are an attempt to deprive Internet systems of their natural advantage." Reply Comments of Trans World Airlines, Feb. 3, 1998, at 6.

The Department's goal in this proceeding should not be to assist the CRSs in expanding their dominance to a new world by erecting new barriers to competitive entry. Instead, the Department should ensure that new competition, using new technology, will be given a fair opportunity to challenge the existing CRS oligopoly and the CRS web interfaces which extend abusive CRS practices to the Internet.

C. Orbitz represents a new opportunity to introduce competition and consumer choice into the travel industry.

Travel is at the heart of what e-commerce is all about. Whether consumers will use the Internet to buy travel is not a question to be decided – it already has happened. The question is simply how much choice consumers should have when they use the Internet to buy travel, and how much competition should there be for their business. Orbitz represents the travel industry's best chance to introduce new competition and consumer choice through the Internet. Moreover, by providing competition in the sale of travel on the Internet, Orbitz also will provide competition to the CRSs. As many parties have argued in their comments, there already is an anti-competitive problem in the travel industry's distribution system. Orbitz is part of the solution to that lack of competition.

1. Orbitz will bring competitive pressure to the Internet and to CRSs with respect to displays.

Orbitz will provide consumers with comprehensive, absolutely unbiased searches and displays of airlines' flights and schedules. In response to any consumer's request, Orbitz will show more airlines, more flights, and more fares than any existing CRS or website. Unlike any CRS-based website, Orbitz will search vastly more combinations of flights, fares, and seat availability data on all airlines before returning a display than the CRSs currently do. Orbitz not only will comply with the existing display bias rule – it will go well beyond it. Orbitz's objective is to provide absolutely unbiased displays of every airline's flights and fares, whether or not an airline has an interest in or enters into an agreement with Orbitz.

Orbitz will do this because it has to provide that level of information quality if it is to have any chance of winning consumers away from the two dominant websites that have

exclusive positions on the portals used by most consumers. Orbitz has to do a better job of giving consumers what they want, or they never will take the extra step required to use Orbitz. Orbitz not only has to provide consumers with better information – it has to provide them with information that is better by enough of a margin to win them over from the portal where they enter the Internet. Orbitz offers a written guarantee in its contracts with each airline that it will provide unbiased displays – exactly the same for every airline, big or small, new or old, investors in Orbitz or not. Orbitz now is absolutely obligated to be unbiased. Travelocity is not. Expedia is not. No CRS-based website that Orbitz knows of has that obligation.

Any CRS or travel website could have done this. But none of them has chosen to do so. There was no competition pushing them to make their systems as good as they possibly could be. It was, and still is, in the interest of the old CRSs, and the CRS-based Internet sites, to use their existing legacy technology as long as possible. They will only update their existing systems when competitively pushed to do so. Orbitz is that new competition. Orbitz will bring real competition to the question of display bias by offering fundamentally better information to consumers.

2. *Orbitz will prompt technological innovation.*

Orbitz can offer truly comprehensive and unbiased information because it will use new technology that will not be limited in its searches and displays by the narrow confines of the old CRS technology. Orbitz will provide comprehensive and unbiased flight information by using an all-new system for searching and displaying airlines, flights, and fares. Distributing complete and accurate information about every flight and every fare, every day, is an enormous technological challenge. The CRSs were marvels of their day, but their day was a quarter of a

century ago. Modern computer technology can do things for people today that no one could have imagined possible 25 years ago.

Instead of using legacy technology, Orbitz is using a new generation of processors, providing much more computing power at much lower cost; new, independently developed, unbiased search software designed to search all possible airlines, flights, and fares; and greatly improved seat availability data. The CRSs still rely extensively on old programming languages; Orbitz will use today's Java. Orbitz will be the first site demonstrating that Internet sites need not be based on the old CRS technology.

a. Data storage.

The CRSs still use large disk data storage systems, which have severe limitations on the amount of data they can hold. Today's technology can hold vastly more data at a small fraction of the cost. Today a one inch-by-one inch disk, such as the ones used in ordinary digital cameras, can hold every published airline fare in the United States.

b. Computing power.

Rows and rows of mainframe computers are impressive to look at, but their actual computing power is limited by today's standards. By assembling modern server processors in parallel, instead of using mainframes, Orbitz will have over 1,000 times the computing power of Sabre, the largest CRS, at a small fraction of the cost.

c. Search software.

Orbitz will use new search software that was independently developed beginning 8 years ago by a group of graduate students at the MIT Artificial Intelligence Lab, led by now-Dr. Jeremy Wertheimer. It is the first software that will literally search every airline, schedule, and

fare. The general public already can try out this software at a beta test site (<http://www.itasoftware.com>). Because it only is a test site, it does not yet have the powerful Orbitz hardware or improved seat availability data behind it, and it cannot actually make a booking. Nevertheless, it has become very popular with consumers and travel agents seeking better information than they can get through CRSs or through CRS-based Internet sites today.

d. Seat availability.

Internet travel sites typically show only flights and fares for which seats are available. Today's CRS-based Internet sites use imperfect and outdated seat availability data, typically checking up-to-date data only after eliminating most flight and fare options from consideration. As a result, flights and fares for which seats actually are available often are not shown to consumers because the system mistakenly believes, based on stale data, that no seats are available. The remedy is to obtain fresher seat availability data and to use it earlier in the search process. Orbitz has designed a new system, using expanded telecommunications and data storage systems, to do exactly that.

e. The best information.

Today, when a consumer wants to travel in the U.S. from City A to City B and back, and he or she asks a CRS for airline, schedule, and fare options, the typical CRS will search about 5,000 to 10,000 possible combinations, and it will do it in about one second. The problem is that from City A to City B and back there are usually between half a billion and one billion combinations, once all the possible airlines, over all the possible routings and connections, and all possible fares have been taken into account. A CRS thus searches only about 0.00001% of the options that exist in the marketplace. Despite their rows and rows of huge mainframe

computers and huge disc data storage units, that is the limit of the old CRSs' ability to process information.

A CRS narrows the options it will consider by prescreening out 99.99999% of a consumer's options before it begins to evaluate them based on price and time: connecting flights over points not on the system's predetermined list of connecting hubs – screened out; flights offered by an airline with very few frequencies in that market – screened out. Orbitz, in contrast, will search all half a billion to one billion possibilities to ensure that it displays the best flight options at the lowest fares. Most of these additional possibilities will not be good choices for the consumer – but buried in that pile usually are some desirable options. Orbitz then will present, lowest fare first, the best several hundred possibilities – without regard to which airline provides the service, or what relation, if any, it has to Orbitz. And Orbitz will do it in a format that is readily understandable to the consumer and allows the consumer to quickly judge which options are best. That is the world of perfect information.

Here is a simple fact that some of Orbitz's CRS-based Internet competitors do not want to face up to: at least 99% of the time that Orbitz will show a consumer a lower fare than a CRS-based system, it will not be because Orbitz had access to a fare that its CRS-based competitors did not. It will be because Orbitz did a better, absolutely thorough and unbiased search of the fare information that is available to everybody.

Although Orbitz will not rely on a CRS for its searches or displays, Orbitz's booking function will be handled through Worldspan, one of the smaller CRSs. Orbitz's customers

therefore will be able to book flights on any airline that has an arrangement with Worldspan by which bookings can be made.³

If Orbitz succeeds, others may well follow. Not only will websites provide consumers with better search and display functions, but the CRSs no longer will be able to limit travel agents to an obsolete technology; when they need to, agents will have the option of getting better information from the Internet. Orbitz will jump-start the technological innovation and competitive entry that has been lacking as long as the CRSs have dominated the travel industry.

The best outcome for consumers and competition would be for existing CRSs and CRS-based Internet sites to be subjected to competitive pressure by Orbitz with respect to the quality of information made available. That would ultimately force the legacy systems to update and upgrade their search and display technology, giving consumers better information not only through Orbitz, but from many different systems.

3. *Orbitz will bring competitive pressure to booking fees.*

Orbitz will offer something else that is genuinely new: a form of price competition for CRS booking fees. These fees clearly are excessive. Since 1983, when the Justice Department and others first asserted they were the product of market power and were excessive, these fees have gone up approximately 1400%, while at the same time computing costs have gone down by over 99%. Even though computing costs are not the only component of CRS booking fees, the problem of excessive CRS booking fees clearly has gone from bad to worse in recent years. As

³ That is over 400 airlines worldwide – basically every airline most passengers would ever care about. The notable exception is Southwest, which has a policy of withholding the ability to book its flights from most CRSs, including Worldspan. Southwest does this as part of a unique strategy, i.e., it will not pay a CRS booking fee. Southwest has correctly concluded that not being burdened by those excessive CRS booking fees is a key to success for a low-fare airline. So neither Orbitz nor any other travel agent can book Southwest through Worldspan, or most other CRSs.

the Justice Department explained in 1996, “the booking fees that CRSs charge are widely believed to be at supra-competitive levels and appear to have little relation to costs.” Comments of the Department of Justice, Docket OST-96-1145, at 4-5 (Sept. 19, 1996). CRS booking fees burden the airlines that pay them, and especially small and low-fare carriers, for whom these fees constitute a much larger percentage of their fares and costs. CRS booking fees also burden consumers, who ultimately pay them, and burden travel agents, because the fees raise the costs of selling airline tickets through agents without providing any benefit in return for most of those agents.

Orbitz will, in effect, refund part of the CRS booking fee to every airline that participates in Orbitz as an associate. That option is open on the same terms to every airline. Orbitz will offset the fee to the same degree to each participating airline, regardless of whether it is an investor in Orbitz or not. Orbitz will be able to do this because it will use Worldspan to make the actual booking, and Worldspan will, in turn, pay Orbitz a market segment incentive. CRSs typically pay market segment incentives to the very largest travel agencies, both online and traditional. But only Orbitz has chosen to then share part of that amount with the airline on which the booking was made, in effect offsetting part of the booking fee. Lower booking fees mean lower prices for consumers and more business and lower overhead for both online and traditional travel agents. And the value of that offset to the booking fee is greater proportionally to low-fare airlines than to other airlines, and, in turn, to their passengers, who include the most price-sensitive consumers.

Orbitz will include Southwest flights and fares in its unbiased displays, however, and hopes to soon enter into an agreement with Southwest which will allow its flights to be booked through Orbitz.

Orbitz is committed to taking the next logical step as well – skipping the CRS altogether. Orbitz is developing the technology to link the website directly with each of its participating carriers' internal inventory management systems, avoiding the CRS booking fee completely. It will take time to engineer this link with each airline individually, but the technology is already available. It has just been awaiting a competitive market incentive to be implemented.

If Orbitz is blocked, by cleverly disguised regulatory proposals or by other anti-competitive obstacles, this extraordinary opportunity to finally, through market forces, bring some price competition to CRS booking fees will have been lost. Also lost will be the last, best chance to relieve consumers, airlines, and travel agents of the effects of these burdensome and excessive costs. But if Orbitz is allowed to challenge the chokehold that CRSs have on the travel industry, the CRSs may have no choice but to compete on price, to the benefit of everyone else, especially consumers and low-fare airlines. The Department justifiably has been very concerned over the years about the anti-competitive effects of excessive CRS booking fees, but has been reluctant to directly regulate them. Orbitz is an opportunity to provide some competitive market discipline to those fees, without direct intervention by the government.⁴

4. *Orbitz will give each airline control of its own marketing and booking data.*

The control and distribution of marketing and booking data have been a contentious issue throughout the history of the CRS industry, with respect to both access to the data and its use. As discussed above, smaller carriers allege that larger airlines have used this data to undercut their business and bookings. See, e.g., Reply Comments of Aloha Airlines, et al., at 2 (Feb. 3,

⁴ Some parties have filed comments that urge the Department to directly regulate CRS booking fees. Orbitz does not oppose that concept. However, the Department to date has shown no willingness to take that step. Orbitz, if

1998). Furthermore, aviation is “probably the only industry where the customer has to pay for the data needed to validate an invoice received from the supplier.” Comments of the Association of Asia Pacific Airlines, at 9 (Dec. 8, 1997). The cost of purchasing and processing the data for small and low-fare carriers is also ten to twenty times what it costs larger airlines, relative to their revenues. See Comments of Aloha Airlines, et al., at 9 (Dec. 9, 1997). Yet, no action has been taken to enforce the CAB’s 1984 promise that “[i]f vendors have established fees for these services which are so high as to effectively preclude their purchase by participating carriers, we would consider that a violation of this rule.” Carrier-Owned Computer Reservations Systems, Final Rule, 49 Fed. Reg. 32540, 32558 (Aug. 15, 1984).

Although Orbitz is not a CRS, its system, like that of some other Internet websites, will generate marketing and booking data. Orbitz has decided to prevent similar controversies from arising at Orbitz by simply making all of this data the sole property of the airline on which the booking is made. As a result, airlines will be the sole determiner of what happens to that data, will not be charged for access to information about their own flights, and will not have their data sold or otherwise made available to their competitors.⁵ Orbitz, therefore, will offer airlines better protection and better value than any CRS. The only question is whether the CRSs and their Internet surrogates will respond by offering airlines a similar agreement – including similar CRS reforms – or will they once again try to convince the Department to adopt rules that would preserve the status quo?

allowed to fully compete, offers the prospect that it may, by providing indirect offsets to the booking fee in return for assured access to a carrier’s Internet fares, be able to bring competition to bear on these until now excessive fees.

⁵ The data generated at Worldspan would be handled like any other CRS data and would be subject to the CRS Rules. Orbitz assumes that Worldspan would choose to make this data, in aggregated form, part of their MIDT, but as with any CRS, what they do with the data is up to them, so long as they comply with the CRS Rules.

5. *A great deal of misinformation has been circulated about Orbitz.*

Unfortunately, a great deal of misinformation has been offered to the public about Orbitz by its potential competitors. This misinformation attempts to portray Orbitz as a bogeyman, controlled by airlines and with the singular purpose of destroying competition in the industry. This misinformation also claims that Orbitz is intended to be the final nail in the coffin of traditional travel agents, and that Orbitz has rights to offer special fares to which not even other online travel agents will have any access. Nothing could be farther from the truth.

Orbitz is an Internet start-up company – and is itself a travel agent (with a present 0% market share). Orbitz plans to challenge several of the most dominant and entrenched companies in the travel sector of the American economy. Still, the incumbent CRSs are terrified of new competition and the technical innovation it will drive. They have an interest in the continuation of the status quo, and the most to lose if a new entrant using new technology, such as Orbitz, were to challenge the stranglehold they now have over the travel industry. Their motivation is not their professed concern that competition would be harmed, but instead that competition would be introduced into their highly noncompetitive world. Stated differently, their true concern is not that they will be unable to compete, but that they will be forced to compete.

a. Initial airline ownership.

Much has been made of the fact that airlines are the initial investors in Orbitz, but that is a fact without any regulatory implications. Most potential investors had difficulty evaluating the risks inherent in Orbitz's undertaking, and particularly in Orbitz's new technology. The initial investors in Orbitz were airlines because they had the expertise to understand what Orbitz proposed, to evaluate its risks, and to conclude that it would work and would offer consumers

better information. Moreover, no other set of investors initially were willing to take on the entrenched monopoly that has dominated the travel industry for two decades, or the duopoly which has more recently come to dominate Internet ticket sales. Airlines also are the investors that have one of the greatest incentives to try to bring some price competition to the area of CRS booking fees and to CRS-based Internet sites.

No single airline investor ever has had a majority interest in or control of Orbitz. Having obtained the necessary initial investment from airlines, Orbitz now is seeking and expects to obtain additional investment from non-airline investors, that will substantially dilute the interests of the existing airlines investors. Orbitz anticipates that, by bringing in additional investors and public investment, the interest of airlines in Orbitz together will be reduced below the 50% mark.

Moreover, the fact that Orbitz has five competing airline investors and many associate airlines means that they will balance each other out – none of them would allow Orbitz to do anything to the advantage of any other airline. The result is that Orbitz has no choice but to be absolutely unbiased and neutral, exactly what it needs to do in order to attract customers. Additional investment by non-airlines will only further this goal.

A legitimate question is: why would any of the major airlines want to invest in a site with the objectives of Orbitz? Orbitz will give every airline, big or small, the same unbiased displays – why would the major airlines want to help make that happen? Orbitz will share with every airline, big or small, an offset to the excessive CRS booking fees, which weigh particularly heavy on the smaller airlines. Why would the major airlines want to help make that happen?

Ultimately only the airlines can answer questions about their decisions, but Orbitz has its own opinions based on its understanding of the industry. There are some very legitimate and compelling reasons that the major carriers would want to make Orbitz happen:

- The Internet is a permanent change in the travel industry. Even if only a minority of all passengers ever book flights on the Internet, it will be a sizeable enough minority that no airline can afford to ignore it. Aviation is a narrow margin business, and airlines need to reach every consumer to whom they can profitably sell tickets. The airlines recognize that their own websites, as good as they are for some passengers, will never meet the needs of all consumers who want to use the Internet. Airlines need a way to give consumers who want to use the Internet and who want to search all airlines, flights, and fares for the best options, what they want. The CRS-based Internet sites do not do that; Orbitz will.
- Airlines have to control their costs. One of the costs airlines have been least able to control is CRS booking fees. Some individual airlines pay roughly a third of a billion dollars a year in CRS booking fees, and those costs ultimately are passed along to their passengers. Orbitz is a way to bring normal market pressures to bear on these excessive costs, and to achieve cost savings on part of the airlines' sales.
- The largest existing CRS-based Internet sites act in ways that disadvantage both airlines and their customers. The largest websites, notably Sabre's Travelocity and Microsoft's Expedia, offer to increase an airline's share of the bookings made through that site in return for payment. In other words, for a price the sites will do what they have to do to their system to direct some passengers who would have booked on one airline to another airline, for a price. Some in the industry call this "swinging market share" and some call it "selling bias." Travelocity

euphemistically refers to it as providing a “featured airline” or as “shifting share for our suppliers.” Orbitz, in contrast, will not have any display bias to sell. A site that competes specifically on being comprehensive, neutral, and unbiased in its displays – like Orbitz – will moderate this runaway practice through competitive pressure, benefiting even those consumers who do not choose to use Orbitz.

- Airlines are not certain if CRS-based sites accurately display their fares to consumers. Airlines have found that if they offer a discounted fare, or open up more seats at an existing low fare, to attract more customers, they cannot be sure if those more attractive offerings are ever shown by the largest CRS-based Internet sites to the consumers. Airlines complain, for example, that when they make a low fare available and Sabre lists seats available at that fare, the seats often do not show up in a Travelocity search. This is a disadvantage not only for the consumer, but for the airline, which cannot be sure whether consumers did not respond as expected to the discount because it did not meet their needs, or because consumers never saw the discount on their Internet display. Orbitz resolves such doubts.

b. Collusion is not a legitimate issue.

Some parties claim that Orbitz would offer airlines a new medium through which to collude on price. But Orbitz will be completely useless as a way to collude. The two essential elements of price collusion are secrecy and two-way communication. Orbitz provides neither.

- i. *Orbitz only will have a right to fare data that already is public.*

Over 99% of the time, Orbitz will use data that is sent by the airlines individually to ATPCO, and then is broadcast by ATPCO to all airlines, CRSs, and now to Orbitz.⁶ The rest of the time, Orbitz will receive fare data sent to Orbitz specifically by individual airlines, also via ATPCO. In those rare cases, Orbitz will have a right to those fares under its contracts with participating airlines, because those fares already will have been posted on those airline's websites. So for every fare that Orbitz has a right to display, that fare already will be public and available for sale, through a means other than Orbitz.

- ii. *Orbitz will not provide two-way communication.*

Orbitz will take fare data from ATPCO and instantly make it public. When a consumer makes a booking through Orbitz, initially that booking will be transmitted directly to Worldspan, than to the airline on which the booking is made, not to anyone else. Orbitz will not have an automated mechanism that would allow direct and private communication from Orbitz to airlines about the fares of their competitors. It does not have any reason to build that capability, particularly because the fare data will already be public and sellable.

If an airline were to be so foolish as to want to collude on prices or capacity, there already is a great device available for doing so – one that provides both secrecy and two-way communication. That is the telephone. No one ever has suggested that it would be a prudent idea to rip out all the telephones in America in order to eliminate the possibility that someone,

⁶ Because all of Orbitz's fare data will be relayed through ATPCO, all of the data will be ATPCO Consent Decree-compliant. The decree prohibits an airline from communicating a fare to any party unless at the same time that fare is being made public and is being put up for sale. See *United States v. Airline Tariff Publishing Co.*, 836 F. Supp. 9 (D.D.C. 1994). Fare data flowing to Orbitz will be subject to the Consent Decree, just as fare data flowing to all

sometime might use one for the purpose of collusion. Nor would it be a good idea to try to eliminate other devices that in theory could be used for collusion, such as the fax machines, hotels, and office buildings that regularly assemble competitors for legitimate meetings, or the cars, buses, trains, and – of course – airplanes that bring them together. The Department should continue to rely on the laws that already prohibit collusion, and ensure those laws are enforced aggressively in the travel industry and throughout the economy.

After careful study of this issue, Inspector General Mead has concluded that Orbitz would in no way facilitate collusion on prices by airlines:

We do not see anything unique to the structure of Orbitz that would encourage or facilitate collusion on pricing. The airlines will have no greater access to each others' fares than they currently have through browsing their competitors' websites and purchasing CRS data. In the current state of technology, airlines can become instantaneously aware and respond immediately to changes in their competitors' fares and services – although Orbitz will gather this information more easily in one place, it will not offer a substantially greater platform upon which the airlines can communicate about pricing.

Kenneth M. Mead, Post hearing questions submitted by Senator McCain for Mr. Ken Mead, DOT Inspector General, Aug. 16, 2000, at 4 (forthcoming in the published record of the hearing on Aviation and the Internet held before the Committee on Commerce, Science and Transportation, U.S. Senate, July 20, 2000).

c. Availability of fares.

One of the most glaring pieces of misinformation about Orbitz is the allegation that Orbitz will have a right to exclusive fares, that will give it an advantage over other online travel agents and traditional agents. This is simply not true, and it never has been: Orbitz has no

other online and traditional travel agents is subject to the Consent Decree. Nor would Orbitz want the situation to be any different.

exclusivity agreement with its participating carriers, and carriers as a matter of economic logic are expected to sell fares through any channels in which they can profitably do so.

i. No exclusivity.

Orbitz has not entered into agreements and has no plans to enter into agreements with its participating carriers that would require those carriers to make fares available on Orbitz that they could not offer through any other channel. In fact, Orbitz, in its contracts with its participating carriers, has guaranteed that every carrier – investors and associates alike – has a right of non-exclusivity: they can put any fare offered on Orbitz up for sale on any other website or channel. Orbitz is, in effect, barred by its own contracts from telling any airline that it cannot put a fare somewhere else.

Orbitz's agreements with its participating carriers include a standard non-discrimination commercial arrangement, sometimes referred to as an MFN (Most Favored Nation) clause. Participating carriers are required only to offer Orbitz the same fares that they make available to the general public through any other channel. For Orbitz, this simply means that it cannot be disadvantaged vis-à-vis any other channel. For consumers, this means that they can be confident that the best fares available to the general public will be available on Orbitz.

Nothing prohibits any other website or CRS from making arrangements with each airline to receive every fare Orbitz receives, or prevents any airline from placing any fare it chooses in any channel it chooses. Indeed, Sabre claims to have a similar MFN provision in its contracts with its participating carriers. See Reply Comments of the Sabre Group, at 10 (Feb. 3, 1998).⁷

⁷ But Orbitz intends to use its MFN clause as an incentive, while Sabre apparently intends to use its MFN clause as a bludgeon. Sabre reportedly has threatened to raise its booking fees by about 7% if air carriers refuse to post Internet fares on its system, but would raise booking fees only 3% if they comply. See, e.g., Sabre Threatens Airlines With Rate Hikes, Aviation Daily, Aug. 9, 2000, at 1.

In addition, special fares that are not available to the general public, such as corporate discount fares, government fares, consolidator fares, meeting and group fares, and group affinity fares, are not covered by the Orbitz MFN clause and typically will not be available from Orbitz.

Traditional travel agents still will often be the exclusive source for these special fares.

ii. Airlines will continue to offer fares through all rational distribution channels.

Some parties have suggested that carriers should be required to offer the discount fares offered only through airline websites – so-called “Internet fares,” “web fares,” or “e-fares” – through all ticket distribution channels. See, e.g., Comments of the Association of Retail Travel Agents, at 13 (Dec. 10, 1997). This proposal reflects either a basic misunderstanding of Internet fares, or a conscious attempt to eliminate those fares. Internet fares are for sales of distressed goods, tickets for seats on flights that operate at inconvenient times or on less popular routes, which otherwise would go unsold. Internet fares are offered for sale at such rock-bottom prices that the only means by which they are typically sold are airline websites, where transaction costs are low and neither CRS booking fees nor commissions are incurred. “This practice is common in the travel industry – Amtrak, rental car companies, hotels, and cruise lines also offer some low prices through their websites that cannot be obtained from any other source.” Statement of A. Bradley Mims, Deputy Assistant Secretary for Aviation and International Affairs, U.S.

Orbitz also observes that the MFN clause in its contracts with carriers is entirely unlike the clause that was at issue in the parity clause proceeding, Docket OST-96-1145. Sabre, which is responsible for 46% of all CRS bookings in the United States, required all of its participating carriers to pay for services that they did not want – that is, to pay to participate in Sabre at the same level that they participated in any other CRS. See Computer Reservations Systems (CRS) Regulations, Final Rule, Docket OST-96-1145, 62 Fed. Reg. 59784, 59795 (Nov. 5, 1997). In contrast, the MFN clause in the contracts between Orbitz (a new entrant with a 0% market share) and its participating carriers simply states that those carriers must, through the third-party of Orbitz, make their best fares more widely accessible to consumers than those fares are today.

Department of Transportation, before the Committee on Commerce, Science and Transportation,
July 20, 2000, at 3.

If the Department were to require that Internet fares be sold through all ticket distribution channels, most of those fares would either go up in price or disappear. Consumers would lose this travel option, in particular harming the most price-sensitive passengers. The DOT would, in effect, be requiring the airlines to sell all of their tickets only at a price high enough to cover the costs of the most expensive means of selling tickets, depriving the limited number of consumers who are willing to occupy less desirable seats the chance to get the bargains that now are to be found on the Internet.

More specifically, a major component of the cost differential between an airline selling tickets on its own website and that same airline selling tickets through a CRS is the excessive CRS booking fee. If the Department were to require that all airline fares be sold through all channels, it would in effect be requiring that all fares be priced to accommodate the burden of an excessive CRS booking fee. The Department thus would extend the reach of CRS market power to those relatively few fares not already within CRS control. It would not be in the interests of consumers or of competition to have the Department forcibly extend the reach of CRS market power. It would not only be the equivalent of the Department imposing a tax on the Internet: It would be doubly harmful because the level of that effective tax on the Internet would be determined in large part by the CRSs which the Department already has determined to have market power.

The government does not make an Internet consumer of books pay a price premium equal to that of the most expensive retailer of books. It does not prohibit outlet stores from marking down prices on discontinued or slightly flawed goods, or require purchasers of furniture or

clothing to pay the same prices at outlets that they would have to pay at an exclusive boutique. Air travel should be treated no differently.

Furthermore, if an airline can economically sell tickets through a distribution channel, it has every incentive to do so. Airlines are under enormous economic compunction to sell their tickets by every cost-effective means, whether or not other cost-effective means also exist. That is why today airlines have not ceased selling tickets through traditional agents in order sell them only through in-house agents or websites.

Aviation is a narrow margin business, and no airline ever could afford to miss out on the large pool of potential passengers that only can be reached through travel agents, or through any other retail channel. Even today, any airline that tried to ignore or bypass travel agents would lose tremendous market share to its competitors. Consequently, there is no reason to believe that any carrier would choose to make its fares available only through Orbitz, if any other channels, be they traditional agents, online agents, or another avenue, also can sell those fares economically. Common sense and business realities suggest that every discount fare that today is available to the public through traditional travel agents, websites, and other channels, will continue to be made widely available to the public after Orbitz's launch.

This is not a theoretical or speculative discussion. One need only look at present practice for a real world demonstration. Airlines today have the discretion of choosing which channels to utilize in selling fares. Some channels are significantly less expensive to sell through than others. For example, it costs America West – a carrier with relatively low overhead – \$6 to sell a ticket through its website, \$13 to sell a ticket through an in-house agent,⁸ and \$23 to sell a ticket through a travel agent. See U.S. General Accounting Office, Domestic Aviation: Effect of

Changes in How Airline Tickets Are Sold, at 17 (July 1999). Still, airlines choose to sell more than 99% of their publicly available fares through all channels. This is because they cannot afford to be non-competitive. Airlines do not have the ability to dictate which channels consumers of air travel should use; they therefore must make themselves available everywhere that the consumers choose to shop. Orbitz – which will actually be a more costly channel than a carrier’s own website, but less than most other alternatives – will not change that equation.

iii. Orbitz is a solution to an economic dilemma.

The fact that airlines cannot afford to withhold fares from all profitable channels is the key reason that the CRSs have been so successful in establishing market power over the travel industry. Because almost all travel agents use only a single CRS (and have little chance of ever switching to a different CRS, let alone acquiring a second system), the only way for an airline to effectively reach every agent’s customers is for that airline to participate in every CRS. No airline can afford to be cut off from the sizeable number of retail outlets each CRS has under contract. This was, in fact, the foundation for the finding in 1983 that the CRSs had market power, and was the primary justification for the enactment of the CRS Rules.

On occasion, an airline has refused to pay excessive booking fees and has withdrawn or been expelled from that CRS. In every such case, the airline quickly has conceded defeat because it could not bear the resulting loss in revenue. For example, in 1984 Continental quit PARS (a predecessor of Worldspan) after the CRS raised its booking fee more than 600% (in order to match Sabre’s increase in its booking fees). Continental gave in, resumed participation, and paid the higher fees after just six weeks. During that period, the carrier’s bookings from

⁸ This is a marginal cost estimate; the fully allocated cost of sales through an in-house agent would be far higher.

agents locked-in to PARS had plunged by up to 50%. See Computer Reservation System (CRS) Regulations, Notice of Proposed Rulemaking, 56 Fed. Reg. 12586, 12594 (Mar. 26, 1991).

Nor is the threat of de-listing a carrier a relic of the 1980s. It continues to be the nuclear weapon in the CRS arsenal. In 1996, Sabre reportedly de-listed Varig for three days after the carrier questioned new contract terms Sabre had announced on a take-it-or-leave-it basis. See Reply Comments of Varig, at 4 n.7 (Feb. 3, 1998). America West recounts that “Apollo sent America West an ultimatum” over a billing dispute “requiring payment of the disputed amount in one hour to avoid deactivation. This draconian sanction would of course effectively close-off America West from a substantial segment of the market and impose devastating losses on the carrier.” Comments of America West Airlines, Inc., at 7 (Dec. 9, 1997). See also Comments of American Trans Air, at 3 n.3 (Dec. 9, 1997); Comments of Royal Jordanian Airlines, at 4 (Dec. 9, 1997).

Sabre and the other CRSs have used the fact that each airline must participate in each CRS to unilaterally dictate terms and conditions on each airline. The CRSs have thus distorted the market to their own benefit. Orbitz, in contrast, will allow any carrier to participate in its system on a non-exclusive basis, and will pass back to every associate carrier the same percentage of the excessive booking fees those airlines now are charged by the CRSs. Orbitz, therefore, will, in effect, drive down booking fees in general – which will lower air fares for the consumer – while at the same time Orbitz will expand, not restrict, the wide availability of low-priced fares.

6. *Orbitz and traditional travel agents.*

The last but perhaps most serious misconception about Orbitz is that it will be a player in a zero-sum game against traditional travel agents. Supposedly, if Orbitz wins, then traditional travel agents must lose. But this is not so. Orbitz will primarily compete with other online agents, not with traditional travel agents. Moreover, Orbitz intends to try to change the rules of the travel industry through increased competition so that both online and traditional travel agents no longer will have to play by rigged rules that ensure that only CRSs can win.

a. Orbitz will not compete with traditional travel agents.

At present, about 80% of all bookings are made through traditional travel agents, and only about 4% are made online through airline websites and online agents such as Travelocity, Expedia, and, soon, Orbitz. Forrester Research predicts that the latter figure will increase to about 12% in four years, but the absolute volume of bookings by traditional agents, given the projected growth in total air travel, actually will increase slightly during that same period.

Orbitz's market research also has found that consumers who use travel agents typically do so because they want the person-to-person advice and expertise they get from travel agents. There simply is no reason why Orbitz's launch would cause those consumers to switch to the Internet. That Orbitz will have access to Internet fares now on airline websites does not change this fact. Those fares are now available on the Internet, and yet 80% of consumers still prefer to use travel agents. That those fares – estimated to be a fraction of 1% of all fares – will be available in the future both on airline websites and Orbitz will not fundamentally change the preferences of those consumers who prefer to deal person-to-person with an agent.

However, among the 4% that use the Internet today (or the 12% projected to use it in the future), and particularly among those consumers who want an Internet site that will show them all the airlines and all the best schedule and fare options, there is great dissatisfaction. Airline pricing is complicated and constantly changing. Many Internet consumers complain that they have to go to many different sites to be sure they are getting all the airlines and the best schedule and fare options, because no site gives them all of what they want. They complain that it is extremely difficult to get complete, unbiased, current, and readily understandable information about the best flight and fare options. Orbitz's consumer research found that 92% of users of Internet travel site services are not satisfied with their ability to get all the flight and fare information they want and need at any single existing site.

And it is no wonder that Internet consumers today are dissatisfied. In a recent analysis of CRS-based travel sites, the Consumer Reports Travel Letter put four of the existing websites, including the two largest (Travelocity and Expedia), to the test by entering 19 identical departure and return trips on each site at exactly the same time. All requests were for flights 3 days hence.

The results: The "lowest fare" online rates for the same destination were all over the map – sometimes hundreds of dollars apart. ...

Take the fares we got when we requested a flight on one of the busiest routes in the nation, New York to Chicago, via LaGuardia and O'Hare International airports. Travelocity's first pick was \$785, involving both a change of airlines and a connection seven states away in Atlanta. Expedia's first offer was \$799, but with a 6:30 a.m. departure rather than the 9 a.m. we sought. Lowestfare's lowest fare was \$1,191, and it meant returning at 7:44 a.m. on Wednesday – not at 6 p.m. Tuesday, which we asked for. And Cheap Tickets couldn't process the itinerary at all; we wanted to fly three days later, and the system requires at least five days' notice. Meanwhile, none of these systems beat the lowest fare of \$637, supplied by Apollo, which a travel agent can program to supply viable departure times, no changes of airlines, and no unreasonable connecting times or cities.

The unusual spread of the online offerings raises questions of “display bias,” a practice in which a web vendor may push one airline over another as a result of a special deal with that airline.

“Lowest fares” online are all over the map, Consumer Reports, Oct. 2000, at 8.

The Internet should be able to serve travel consumers better than that. Indeed, modern computing and communication technology should be an enormous boon to consumers dealing with complex and ever-changing airline fares. But to date, the CRSs and their old legacy systems have cared more about defending their turf than about modernizing their technology to provide the best possible information to consumers. And the CRS-based Internet sites are no better than the CRSs which provide their searches and displays, and sometimes, as Consumer Reports discovered, are worse. Consumers deserve far better information than they are getting today, and Orbitz will demonstrate that new technology can, in fact, give consumers what they want and deserve. That only can be a positive development for consumers and for competition.

Orbitz is designed to remedy the dissatisfaction of the consumers that already use the Internet. Orbitz’s plan simply is to give them what they want – comprehensive and unbiased information about flights and fares. Orbitz’s customers will come primarily from other websites, not from traditional travel agents, because Orbitz will not routinely provide what the customers of travel agents still want, which is person-to-person service. On the other hand, Orbitz will provide what the dissatisfied consumers of other websites have long been looking for, which is the comprehensive and unbiased information they want and need to book their travel.

Moreover, it is important to understand that Orbitz itself will be a travel agent, like hundreds of other online travel agents. While, like similar travel agencies, it will have multiple sources of revenue, it expects its primary source of revenue to be commissions from airline ticket sales. Commissions are, and have been since the Competitive Marketing Case, individually

determined in the marketplace by airlines. Orbitz is of the opinion that airlines individually will choose to pay Orbitz the same base commission they pay other online agents (at present averaging about 5% to a \$10 cap).

b. Traditional travel agents are and will remain an essential part of the industry.

In 1999, the American Society of Travel Agents conducted a survey of agent budgeting and profitability, and found that “[c]ontrary to the hype, travel agencies are doing better than ever.” The Latest Survey Confirms It: Travel Agent Industry Is Alive and Well, ASTA News Release, Aug. 18, 1999. According to ASTA, half of the agencies that participated in the survey reported that their client base had grown in the previous year, and only 13% of the agencies even believed that they had lost business to the Internet. See id. ASTA President and CEO Joe Galloway added that “[d]espite the doomsday forecasts by many industry experts, the Internet is not carving away at travel agent profitability, in fact, the exact opposite is occurring.” Id. ASTA recently confirmed that travel agency sales of tickets in March 2000 were up 10% over sales in March 1999. See ASTA says Bear Stearns report doesn’t add up, O’Dwyer’s PR Services Report, Aug. 2000 (ASTA response to the Bear, Stearns & Co. report entered in this docket).

Traditional travel agents and online travel agents often appeal to different types of consumers. The Internet is a useful way for independent-minded consumers or consumers with simple and/or flexible travel plans to purchase air travel. But when it comes to making complex travel plans, as well as for consumers that prefer person-to-person service, “increasing numbers of consumers are turning to travel agents for their assistance and expertise.” ASTA, The Latest Survey Confirms It. “Many travelers value the personal relationship they have with their travel agent, and a key part of that relationship is the travel agent’s ability to solve problems if

something goes wrong.” Statement of A. Bradley Mims, Deputy Assistant Secretary for Aviation and International Affairs, U.S. Department of Transportation, before the Committee on Commerce, Science and Transportation, July 20, 2000, at 3. In sum, Orbitz agrees with ASTA that traditional travel agents have a bright future, as do online travel agents, and that traditional and online travel agents can constructively co-exist in a marketplace where not all consumers have the same needs or the same preferences with regard to retail channels.

c. Orbitz will be a small overall player.

As discussed above, Forrester Research projects that online travel bookings will grow from 4% to 12% of all bookings over the next four years. But that growth is expected to be less than the growth rate for air travel in general, meaning that in that time period bookings through travel agents are actually expected to increase slightly. Furthermore, half of that 12% are expected to be airline website sales, leaving only 6% of all bookings for all online agencies. Orbitz, if completely successful, will account for one to two percentage points out of that 6%. There is no way that Orbitz’s one-to-two percent share of all travel bookings is going to put anybody out of business. And Orbitz still has many obstacles to overcome to even reach its goal of becoming the #3 agency for online travel, a challenge which has only been made more difficult by the tactics some of its competitors have engaged in to try to prevent it from entering the market. See, e.g., Bear, Stearns & Co., Inc., Internet Travel – Point, Click, Trip: An Introduction to the On-Line Travel Industry, April 2000, at 59 (“daunting steps need to be taken before [Orbitz] becomes a reality”).

d. Orbitz will pioneer technology that will benefit traditional travel agents.

Finally, Orbitz and the technology it is pioneering are likely in the future to provide important technological benefits not just to consumers on the Internet, but also to travel agents:

i. *Orbitz will bring technological competition to the industry.*

Orbitz expects that not only will its new technology result in better displays and better information for consumers on the Internet, but that CRSs and their Internet sites will respond to that new competition – once they get tired of trying to block it – by upgrading their searches and displays. Travel agents have to use considerable skill and energy to work around the technological limitations of the CRSs. Better, more user-friendly displays would make the tough job of a travel agent a bit easier.

ii. *Orbitz will ease the squeeze on travel agents caused by higher and higher CRS booking fees.*

The airlines' costs of selling a ticket through a travel agent consist mainly of the travel agent commission (paid to the agent) and the CRS booking fee (paid to the CRS). The CRS booking fee has been going up steadily, with the result that a higher and higher percentage of the cost of selling through a travel agent has been going to the CRS, not the travel agent. To put it bluntly, the CRS is eating more and more of the travel agent's lunch. Orbitz will for the first time bring some degree of price competition to the world of CRS booking fees. To the extent that new competition can drive down CRS booking fees, or at least limit their growth, travel agents should get a larger share of the value of selling through the travel agent channel, and selling through the travel agent channel would become a more cost-attractive proposition for airlines.

iii. Orbitz will put competitive pressure on the one CRS-one agent problem.

If agents easily could switch CRSs, they soon would find that CRSs were willing to share more of their revenues with the agents. The agent would find himself or herself in a free-market relationship with the CRS – something that has rarely if ever happened – and would be able to share in more of the value that he or she generates for CRSs. Orbitz is designed for use by Internet consumers, not agents (although agents are welcome to use it for free). But once Orbitz has developed and demonstrated this technology, it only would take a different business model for Orbitz or someone else to offer a version of that new technology directly to travel agents.⁹

This is why Sabre and Travelocity are working so hard to block Orbitz. Sabre has lived for two decades off the power of having the largest number of agents locked up under highly restrictive contracts. If, thanks to a technology revolution started by Orbitz, the agents under Sabre's thumb could exercise some choice, then the CRS would have to share far more of the value generated by agent sales with those agents. For Sabre and Travelocity, that is not a happy prospect.

⁹ Indeed, travel agents using ITA Software's beta site report that it is as fast and as good or better than a CRS at finding low fares, and sometimes has fresher seat availability data. See Dennis Schaal, Travel agent taps technology Orbitz will use for airline site, Travel Weekly, Aug. 3, 2000, at 1.

II. INTERNET AIR TRAVEL SALES SHOULD NOT BE SUBJECT TO ECONOMIC REGULATION

A. The wholesale extension of Part 255 to the Internet is not required and would threaten competition.

Orbitz opposes the extension of the CRS Rules as a whole to the Internet. Certain parties have endorsed such a proposal out of a professed belief that it would best protect consumers and competition. It would not do so. The concept of applying the existing CRS Rules wholesale to the Internet has been enthusiastically endorsed by Sabre/Travelocity because they hope that the non-display related provisions of the CRS Rules would grant them compulsory access to Internet fares without regard to relative distribution costs and without regard to other CRS reforms. If they were to succeed in that effort, it would further entrench the market power of the CRSs, and the dominant CRS-based Internet sites, over the travel industry. This proposal specifically has not been endorsed by Inspector General Mead, for exactly that reason. And as a recent editorial stated, “we’re certainly not convinced that ... rules designed for B2B systems of 15 years ago are relevant to the Web of today.” Hold it right there, Travel Weekly, July 31, 2000, at 72.

1. *Travelocity and most other travel websites would not actually be covered by such an extension of Part 255, and the troubling question of whether Part 255 would continue to cover Sabre would remain unclear.*

Sabre and Travelocity want Internet sites to conform to the CRS Rules, but they do not want to have to play by those rules themselves. The CRS rules currently apply only to CRSs owned, controlled, operated, or marketed by airlines. So if the existing CRS Rules were applied “as is” to the Internet, Travelocity would not be covered by those rules. Neither would most Internet sites. Furthermore, the question of whether Sabre is covered at all by the CRS Rules

now hangs by the thin thread of whether Sabre is marketed by an airline – a question that gives Sabre considerable room to argue whichever side of the question it finds more protective of its market power at any point in the future.

The anti-competitive problem that the CRS rules were meant to address was the fact that CRSs had agents under long-term contracts, which the agents had little real chance of ever getting out of, as well as that airlines could not bargain with CRSs because they had no other way to access the customers of those agents. Sabre today has more agents than any other CRS under these highly restrictive and binding contracts, and therefore has exclusive access to more consumers than any other CRS. But because Sabre is no longer airline owned, the CRS Rules arguably no longer govern its conduct. Although Sabre so far has continued to comply with Part 255 – or at least with its interpretation thereof – there is no guarantee that Sabre will continue to do so once this rulemaking is concluded. Sabre could then, for example, adopt the strategy of its Internet arm, Travelocity, and once again sell bias to airlines, could charge discriminatory (as well as excessive) booking fees, and could impose ten-year contracts and exclusive use clauses on its agents.

2. *The mandatory participation rule should not be applied to the Internet.*

If the Department were to require airlines to make all of their fares available through every ticket distribution channel, as some parties have urged, the results would include a gross distortion of the market and harm to consumers, particularly to the most price-sensitive consumers. Such a requirement would, in effect, ban the low fares that the Internet has made possible, because they would be uneconomic if they had to be sold through more expensive channels (e.g., through a CRS that charges monopolistic booking fees for each ticket sold).

But that is what the mandatory participation rule (Part 255.7) might do if extended to the Internet. The rule today requires that a carrier-owner of a CRS provide fare information to “each other system in which it participates on the same basis” as it provides fare data to its own system. If that rule were extended “as is” to the Internet it could be argued (not by Orbitz) that any airline subject to the mandatory participation rule – and it already applies to airlines that carry more than half of domestic passenger traffic – that posted Internet fares on Orbitz or on any other multi-airline website also would be required to also make those fares available through CRSs.

The issue would be, and the Department would be called upon to decide, what “on the same basis” means in that context. If it were held to mean that any airline that offered similar benefits to Orbitz (i.e., an indirect offset to the CRS booking fee, an end to biased displays and paying extra for that bias, individual airline ownership of marketing and booking data, etc.), then the potential for the pro-competitive reform of CRS practices would be enhanced, but the Department might find itself in an adjudicative tangle about whether a particular offer did or did not offer similar benefits and was “on the same basis” as the Orbitz arrangement. Conversely, if it were held to mean that fares given by airlines to Orbitz had to be given to all other channels without regard to the commercial terms each channel offered or whether those terms included badly needed CRS reforms, then the effect would be to, by government fiat, further extend the market power of the CRSs into the Internet and to erect government-imposed barriers to new competition to the CRSs and their Internet surrogates. It is critical that the Department fully understand the potential anti-competitive and anti-consumer consequences of that latter course.

It is important, first, to understand the effect of Part 255.7 on Orbitz and on the new competition and new technology Orbitz is attempting to introduce to an automated distribution arena short on both. Orbitz is not concerned that other channels might gain access to those

Internet fares which now typically can only be booked through an airline website.¹⁰ Orbitz, in fact, assumes that, if the Department does not order Internet fares to be made available through all distribution channels without regard to cost or the willingness of CRSs to reform their practices, some competing channels would choose to make offers to airlines similar to Orbitz's. That is, the CRSs would offer to reform their practices by lower their booking fees, providing less biased and more reliable displays, and giving each airline control over their own marketing and booking data, in return for access to that carrier's Internet fares. What would be of very serious concern to Orbitz, however, would be if, the Department mandated that all fares be made available through all channels, without allowing airlines to negotiate with regard to booking fees or other reforms of CRS practices. The Department, however unintentionally, would burden Internet fares with the monopolistic costs of the CRS booking fee and other anti-competitive CRS practices, and thereby would eliminate or vastly reduce the availability of Internet fares through any channel.

If Internet fares were to be eliminated or made less attractive to consumers – e.g., if Part 255.7 were applied to the Internet and were held to require such fares to be given to CRSs rather than be the subject of market bargaining between individual airlines and CRSs or CRS-based websites – not only would the consumers who rely on those fares be harmed, but an important part of Orbitz's consumer appeal would be lost, even though that appeal is out of proportion to the actual number of Internet fares available in the market today. Internet fares constitute a

¹⁰ There are already numerous websites that every week gather the Internet fares that are publicly displayed on dozens of airline sites and then make a list of them all available to the public in one location. Examples include the websites of ABC News (<http://abcnews.com/sections/travel/Airfares/wedfares.html>) and of the Washington Post (<http://washingtonpost.com/wp-srv/travel/online/airfares.htm>), as well as travel websites such as intellitrip.com, travelzoo.com, and webflyer.com. What Orbitz will bring to consumers, in addition to the capacity to book Internet fares, is a more reliable, more accurate, more comprehensive, and better integrated and more user-friendly display of all relevant information, including Internet fares, that the consumer would want to see before making a decision.

fraction of 1% of all fares, so their absolute significance is quite small. However, if Orbitz is to have any reasonable chance to establish itself as an online agency in an environment totally dominated by two established sites, where each has a parent company subsidizing them with monopoly rents from other businesses, and where between them they have locked up through exclusive deals most of the portals through which consumers browse the Internet, Orbitz must be able to hold out to consumers that it has access to all fares, including Internet fares. If Internet fares cease to exist, Orbitz would still offer numerous other advantages (such as superior search and display of information), but it is unclear whether that would be sufficiently understood by most consumers, particularly given the structural advantage the Big Two travel websites have armored themselves with, such as their web portal exclusives. See Exhibit A.

Second, it is important to understand the effect of such an approach on consumers. The effective demise of Internet fares would be a tremendous blow. The most price-sensitive consumers, such as students, minorities, and the elderly, who have been able to gain unprecedented access to air travel in recent years because of Internet fares, would again be excluded from the benefits that e-commerce makes possible.

Orbitz is aware and concerned that there may be a “digital divide” that limits some Americans’ access to the Internet. But the solution to this problem is to make information on the Internet more accessible, just as Orbitz plans to do,¹¹ and to ensure that access to computers is widely available, such as through public schools and libraries. The solution is certainly not to

¹¹ For example, consumers who need a last-minute ticket to attend a relative’s funeral often could in theory find a better fare than a bereavement fare, but usually lack the time and energy to go fare-hunting across the Internet. See Nancy Ann Jeffrey, *Mourning Becomes Expensive*, Wall Street Journal, Aug. 18, 2000, at W4. Orbitz will make it easier for family and friends to deal with such unexpected tragedies. Regulatory directives which, however unintentionally, burdened Internet fares with externalities such as excessive CRS booking fees, would reduce or deny that option to consumers.

“dumb down” the Internet by mandating that websites give consumers no better travel opportunities than existing channels, and thus eliminate the lowest fares for everyone.

Indeed, the only beneficiaries of extending the mandatory participation rule to the Internet, and interpreting it to mean that Internet fares must be given to CRSs and their Internet surrogates without any reform of CRS abuses, would be the CRSs and their Internet surrogates. The Department long has been concerned that CRS booking fees are excessive, and that they add billions of dollars every year to the fares passengers have to pay for air travel. A central finding of the CAB and the Justice Department in 1983-84 (and of the Department and the GAO in subsequent studies) is that control over access to fares has not been sufficient to give airlines the bargaining leverage necessary to create a competitive market for booking fees, in which the fee charged to distribute fares reasonably is related to a system’s costs. This is because each CRS had (and continues to have) absolute control over the agents under contract, and no airline ever could afford to turn its back on those agents and their customers. As a result, airlines have no leverage with which to bargain with each CRS to achieve reasonable fees.

The Justice Department advocated, the CAB imposed, and the Department renewed, regulations which tried to stand in the place of that missing marketplace choice and bargaining. While these rules had some success in controlling screen display bias, they have failed with respect to excessive booking fees. The only fares that are now not burdened by these excessive fees are those that are bought directly from airlines, including from their websites. But if the mandatory participation rule were extended to the Internet, and were interpreted to require airlines that posted fares to the Internet to also post them on CRSs, all fares would need to be priced at levels sufficient to pay those excessive booking fees. The airlines would have to raise the prices of their Internet fares – if they continued to offer them at all – in every distribution

channel, including their websites and Orbitz, to include the added expense of CRS booking fees. In other words, consumers would have to pick up the costs of the CRS booking fee even for those fares where a booking fee was not actually paid to a CRS.

There is no rational reason why, after years of being concerned about the anti-competitive and anti-consumer effects of excessive CRS booking fees, the Department now would decide forcibly to extend them to the few places they do not already exist; would decide to force consumers to pay them on all fares as a practical matter; and would decide to provide artificial price protection to the very CRS booking fee they have found to be excessive and the product of anti-competitive market power. Indeed, the Department recently stated that it has “consistently read the pro-competitive policy directives in 49 U.S.C. § 40101 as allowing each airline the same freedom to choose the channels and terms for distributing its services that firms in other unregulated industries enjoy.” Third-Party Complaint of ARTA, Docket OST-96-1995, Order 99-4-19, at 5 (April 29, 1999). Yet, that might be what an extended mandatory participation rule would do.

3. The extension of the existing display bias rule to the Internet is neither necessary nor the most effective remedy.

Although it has eliminated the most egregious examples of bias, Part 255.4 has been ineffective at preventing bias as a whole. Part 255.4 bars only one form of bias – the explicit use of carrier identity in display algorithms such that one airline is favored over another.

The CRSs have continued to use many other forms of bias. There is an infinite number of algorithms they can use that do not contain a carrier-specific factor – and the CRSs get to pick the ones that, on average, will most accomplish whatever it is they wish to accomplish. CRSs also can circumvent the rule altogether – they legally can distribute biased software that runs on

top of the CRS. And the display bias rule even accommodates the search limitations of the obsolete technology of the CRSs, instead of spurring them to upgrade and innovate. The rule tolerates the use of connection tables when a CRS searches for connecting flights. So long as it checks a minimum number of connecting points, a CRS can filter out 99.99999% of a consumer's possible options before it begins to evaluate them based on price and time. This is a form of bias based on system limitations, which is a perverse incentive for the CRSs not to try to resolve their limitations.¹²

A rule requiring CRSs to upgrade their technology to eliminate continuing sources of bias would be a benefit for consumers, travel agents, and airlines. But the Department probably is not willing to impose such a sweeping measure on CRSs. In any case, such a requirement would be unnecessary if there were real competition in the CRS industry. In a competitive market, CRSs would update their technology on their own initiative, in order to provide the most attractive services to their customers. The CRSs have been able to continue to market 1960s vintage technology because there is no such competition among CRSs today. Although not a CRS, Orbitz will create that competition, by using new technology to compete for customers on the fundamental basis of better, comprehensive, readily understandable, and unbiased displays. CRSs would, at the very least, need to update their search and display capabilities so that their Internet surrogates would not be at such an information quality disadvantage to Orbitz. And having made that upgrade, it is hard to imagine that they would not also utilize it on the CRS displays made available to travel agents. If Orbitz is given a chance to compete, and succeeds,

¹² In 1997, minor revisions were made to the display bias rule: CRSs must now provide a display that does not give preference to on-line connections over interline connections, and displays that neither use elapsed time as a significant factor in selecting flights, nor prefer single-plane flights over connecting services, are now prohibited. See Fair Displays of Airline Services in Computer Reservations Systems (CRSs), Final Rule, Docket OST-96-1639,

the Department might not need to further regulate display bias, because the invisible hand of the market might be able to do so through competitive market discipline.

However, Orbitz's displays would not be affected if the Department were to decide to extend Part 255.4, limited as it is, to all travel websites and CRS web interfaces that are held out as providing unbiased information about multiple airlines. That would be because Orbitz's displays will go well beyond mere compliance with Part 255.

It would be highly objectionable and prejudicial, however, if the display bias rule were extended to only some travel websites and did not apply to all online travel agents and CRS web interfaces that display airline schedules and fares. Despite comments by certain parties in 1997 that travel websites were unlikely to sell bias, that is exactly what some (most notably Travelocity and Expedia) have done.

Travelocity and Expedia both approach airlines and offer to "swing market share" for compensation. They do move market share very effectively – their ability to add percentage points to an airline's share in a particular market is quite impressive. Whether they do it by altering the display algorithm, or in other ways, or a combination of many ways, it is unlikely to cease, so long as they have so little effective competition.

It would make no sense for the Department to regulate the displays of what would be the only truly unbiased system (and the only system with a contractual obligation to be unbiased), and not to regulate the displays of those that clearly are biased. Certainly, if the Department were to apply the display bias rule to the Internet, it should apply those rules to all online agents

62 Fed. Reg. 63837 (Dec. 3, 1997). But these remedies only dealt with a few of the techniques that CRSs have learned to use in the past two decades to continue to bias displays, despite Part 255. See id. at 63844.

and CRS interfaces that display airline flights and fares.¹³ In addition, the Department should make clear that if an online agency accepts payments from individual airlines, in the form of override commissions or otherwise, for the purpose of “swinging market share” by biasing its displays in favor of those airlines, that agency would not be considered to be in compliance with its anti-bias requirements.

However, Orbitz firmly believes that the most effective way for the Department to remedy the bias problems of existing CRS-based Internet sites, including the excesses of selling bias, is to simply make sure that Orbitz (and the vastly improved search and display technology that Orbitz is pioneering) will not be hamstrung in its ability to bring new competition to those sites. Orbitz believes that, given widespread Internet consumer dissatisfaction with the quality of information now available on existing travel websites, a competitive appeal to Internet consumers based on superior information will be effective, if Orbitz can persuade consumers to try and compare Orbitz for themselves. Orbitz expects this appeal will be sufficiently effective not only to attract Internet consumers to Orbitz, but to then prompt competing sites (or their CRS parents) to invest in improved search and display capabilities and to limit the extent to which they can bias their systems in return for payment. Thus, Orbitz expects healthy competition on the quality of information provided to Internet consumers to improve the offerings of all competitors and to benefit all Internet consumers. Orbitz does not expect its competitors, in the face of competition from new technology, to simply stand still and continue to offer their present limited and biased displays.

¹³ Orbitz, like virtually all other parties that have submitted comments on the subject, does not propose that websites operated by a single carrier or by a DOT antitrust-immunized alliance of carriers should be subject to the display bias rule. “[A] passenger accessing a web site identified to an individual carrier understands that flights on the proprietor will receive top billing.” Comments of British Airways, at 6 (Dec. 9, 1997).

4. *Other CRS Rules would not make sense in the context of the Internet.*

An additional reason why the Department should not extend the CRS Rules to the Internet is that some of the rules simply would make no sense in the context of the Internet:

- The subscriber contracts rule, Part 255.8, limits the terms and conditions of a contract between a CRS and a travel agent. This rule has no application to websites, which are free to be used by any websurfer, whether a travel agent or a member of the travelling public, and do not require user contracts.
- The third-party equipment rule, Part 255.9, not only assumes the existence of a contract between a CRS and a travel agent, but also assumes the existence of vendor-specific hardware. Neither Orbitz nor any other travel website provides consumers or travel agents with computer equipment, nor does it seem probable that a travel website would ever do so.¹⁴
- The marketing and booking data rule, Part 255.10, may be completely inappropriate for some travel websites. As described above, Orbitz will collect data relating to its participating carriers, but by contract this data will belong to the carriers, not Orbitz. Orbitz cannot make available to others what it does not itself own. In addition, some travel websites simply are gateways to CRSs, and these sites do not now and should not be required against their will to collect marketing and booking data.

¹⁴ Some parties have filed comments that express concern about the relationship between Microsoft and Expedia, given Microsoft's dominant position in the market for computer operating systems. See, e.g., Comments of the Aviation Foundation and Other Interested Parties, at 5 (Dec. 9, 1997); Comments of the American Society of Travel Agents, at 4 (Dec. 9, 1997). Orbitz does not take a position as to whether the Department should or could respond to

In sum, the CRS Rules were drafted for an environment very different from the Internet, and cannot simply be extended to that new territory. Most of the rules would do little good in the context of the Internet, and many would actively harm consumers and competition. Indeed, government has never before successfully enacted rules that directly and specifically regulated the content of the Internet, and to start doing so in this context would have societal implications far beyond air transportation. There is widespread concern that once the government starts regulating the specific content of the Internet, even for a worthy purpose, it will be that much harder to keep that regulation from spreading to many other aspects of the Internet. The Department should be wary of crossing the Rubicon of regulating Internet content.

B. It would be difficult if not impossible to, by regulation, require airlines to enter into identical deals with other websites as they have with Orbitz.

At a hearing held on July 20 before the United States Senate Committee on Commerce Science and Transportation, Inspector General Mead proposed that if other travel websites were to offer an airline CRS reforms like those offered by Orbitz (specifically, booking fee offsets, unbiased displays, and data ownership), in return for the same access to Internet fares that Orbitz has received, then the airline should be obligated to accept the deal.

There is much to be said in favor of the Mead concept. Mr. Mead understands that the key issue before the Department is not simply access to Internet fares, and that CRSs should not simply be granted access to Internet fares without offering up key and long-needed CRS reforms. Instead, the Mead proposal recognizes that access to Internet fares can be a constructive and appropriate opportunity by which to finally bring some restraint to CRS booking fees and the

these concerns. However, if the Department were to respond, it should not do so by tinkering with the existing Part 255.9, which was drafted for a very different purpose based on very different assumptions.

issue of bias. Mr. Mead has rejected the idea that the Department simply should require airlines to give CRSs and websites access to their fares. Instead, he would allow them access to a carrier's Internet fares on the same basis as Orbitz – i.e., a CRS or website would have to offer carriers the same highly pro-consumer and pro-competition benefits that Orbitz has guaranteed them by contract in order to obtain the same fares that they will give to Orbitz – benefits such as an offset to CRS booking fees and unbiased displays. At the heart of the concept is the straightforward idea that if another channel truly offers an airline the same benefits as Orbitz supplied in return for the same benefits that airline gave to Orbitz, it is reasonable that the airline would accept such an arrangement.

At the outset, it is important to remember that there is nothing in the agreements between Orbitz and its participating carriers that prohibits a carrier from entering into a similar deal with another travel website, such as Travelocity, or with an entity in any other channel of ticket distribution. Nor, for that matter, is there anything in these agreements that would prevent an airline from entering into a less favorable deal, if it so chose. Orbitz believes that an airline would accept a deal with another website if its deal were truly equivalent to the Orbitz deal; the result would be lower booking fees and the wider availability of its fares – a good thing for both the carrier and for consumers. Because it would require what carriers already can and would do, Orbitz believes that the goal of Mr. Mead's proposal will be achieved without rulemaking.

However, attempting to implement the Mead proposal through rulemaking would not only be unnecessary, but so complex and difficult as to be impractical, and would embroil the Department in the review of every discussion between airlines and CRSs. The full implementation of the Mead proposal would encompass such issues as:

- A requirement that the CRS affiliated with that channel of ticket distribution truly offer net booking fees equal to those available through Orbitz for all fares. A CRS could not increase its booking fee in order to make up for the booking fee offset that was offered. In other words, the Department would, in effect, have to ban any increases in CRS booking fees in order to give this requirement any validity.¹⁵ This is a step that Department has in the past been unwilling to take.
- A requirement that the search and display functions offered by the channel would have to be as comprehensive and unbiased as Orbitz. If they were not – and especially if bias were for sale to the highest bidder – airlines would not get equal value to what they will get from Orbitz and would have no certainty that their fare initiatives would be reliably displayed.
- A requirement that the channel would have to offer full ownership of booking and marketing data to participating carriers – one of the additional values that Orbitz offers airlines, and an important pro-competitive feature of Orbitz.

In addition, if the Department were by regulation to try to “level the playing field” and provide all participants in the Internet marketplace with equal access to the resources they might desire in order to compete effectively, the rule could not focus on just one resource (i.e., Internet fares, as seized upon by Orbitz’s adversaries), but should also encompass other key resources for an Internet-based business (e.g., access to the major Internet portals). Sabre and Travelocity

¹⁵ Indeed, if the Department were to directly regulate booking fees, it should consider requiring the CRSs to reduce their booking fees to levels that are reasonably related to costs, so as to reflect the vast decline in the cost of computing power over the past twenty years.

contend that they must have access to Internet fares in order to compete, even though they are unwilling to match what Orbitz offers in return for access to those fares, and even though Orbitz has no exclusive agreements for access to those fares. At the same time, Sabre/Travelocity, along with Microsoft/ Expedia, have secured exclusive access to the six most-visited Internet portal sites, including AOL, Yahoo and MSN – exclusives that Travelocity describes as critical to its success. See Exhibit A.¹⁶ These exclusives cover the portals through which 90% of all Internet users explore the Internet. But Sabre and Travelocity would deny Orbitz – or any other new entrant – a chance to obtain access to these key portals, even if Orbitz were willing to meet or beat the terms Sabre/ Travelocity or Microsoft/Expedia have paid to obtain such exclusivity. There is no reason that a regulation should dictate that the dominant, established players in online travel get access to one potential resource, but continue to allow those players to retain contractually exclusive access to another.

Furthermore, a regulation implementing Mr. Mead's proposal would have to ensure that all of the benefits of Orbitz's arrangements with its participating carriers were replicated in another entity's offer, if that entity were by right to obtain in return what Orbitz has, which is access to publicly available Internet fares. Such a task would involve a massive and detailed rule, and anything less would allow CRSs to obtain the benefits of Orbitz's deals without truly providing the full range of benefits which Orbitz provides. Any rule which only partially implemented Mr. Mead's proposal would quickly be circumvented and would serve only to further entrench the existing CRS oligopoly.

In short, Mr. Mead's concept would be better implemented by no new rule at all (because the concept describes what should happen absent a rule in a free and open market) than by an

¹⁶ See also Travelocity's form 10K-405, filed March 30, 2000, and Travelocity's form 424B3, filed Feb. 8, 2000.

imperfect and incomplete rule. It is a concept best implemented by market mechanisms, not by a regulatory mechanism.

What is important is that Mr. Mead clearly recognizes the central concern here: will the CRSs be able to get access to all airline Internet fares without having to offer price competition for CRS booking fees and other distribution system reforms in return – or will the CRSs finally have to allow those long-sought reforms and competition in order to gain access to Internet fares? Some of these oligopolists want something for nothing – and above all to perpetuate their market power. They want the Department to accomplish that end for them, by adopting proposals that are couched in pro-competitive terms but that in fact would either directly prevent new competition or give the CRSs free access to the same data that Orbitz needs to compete with them.

If the Department adopts the proposals put forward by the entrenched interests such as Sabre/Travelocity, the best and last hope for any price competition in the CRS industry, and other related reforms, will be lost. Having failed to deal with excessive booking fees by regulation, the government would take the next step of forever preventing any chance of marketplace competition limiting the already excessive CRS booking fees. The harm to competition and to competitors (especially for low-fare airlines) and to consumers would be enormous.

C. The worst course of action would be for the Department to try to regulate in haste hypothetical and speculative future circumstances which are unlikely ever to occur.

Some may argue that issues related to Orbitz should be dealt with in regulation by the Department before Orbitz is fully operational, now scheduled for June 2001. Nothing would be

worse for the Department's ability to promulgate rules which deal with real, not imagined problems, and which address those problems with a minimum of unintended consequences.

Serious competition issues have existed in the CRS industry and continue to exist today. The Internet has the ability to provide new competition that could improve the practices of the CRS industry and of existing CRS-based online agencies, with respect to booking fees, display bias, booking data access, and other issues. It is imperative that the government not take any action which would, however inadvertently, prevent the Internet from playing this important pro-competitive and pro-consumer role. Otherwise, government would find that it had simply helped perpetuate and entrench the CRS problems it has long been concerned about.

In this regard, it is particularly important to recognize that Orbitz has not even come to market yet. What we are dealing with are wild speculations about what might happen in the future, not acts that have occurred. It would seem highly prejudicial to remedy problems that have not occurred, and are quite unlikely to ever occur. (This is particularly true when the established players who fret that they might not get access to all fares in the future, today hold by contractual right exclusive access to key Internet properties.) Even in the CRS arena, where the problems already existed and were well known and thoroughly analyzed by government, the resulting regulations often proved ill-suited to solving the problems. To regulate before any problems even exist and can be known is far less likely to produce regulations which are effective and which avoid unintended and negative consequences. At this point, if government were to regulate, it would be chasing ghosts, often ghosts conjured up only in the fevered imaginations of competitors – parties whose interests should not be assumed to be the same as those of consumers. We should allow reality to catch up with this debate. The Department should identify an actual disease before starting to inject the patient with drugs. There will be

time enough to observe whether any of these dire predictions have any basis in reality, and to correct actual problems in the unlikely event they occur.

It should be noted that the Department will retain its full statutory authority under Section 41712 of the Federal Aviation Act to deal, either by regulatory action or by enforcement, with any unfair business practices that might arise. Nothing is lost by attentively waiting to know whether any of these speculations will become reality, and if so, which ones, in what manner, and to what degree. Accuracy is greatly approved when the target actually can be seen. Not only is ammunition conserved, but collateral damage is greatly reduced when one does not fire in the dark at targets which may turn out not to be phantoms, or worse, to be friendly.

III. THE CRS RULES CAN AND SHOULD BE REPAIRED.

A. The existing CRS Rules should be continued.

Although imperfect, the CRS Rules as a whole should be continued. The CRS Rules were a necessary response to deceptive practices, such as screen display bias, as well as other practices, which were made possible by the dominance of a handful of CRSs with market power. CRSs still have travel agents locked-up in contracts which make it practically impossible for most agents to ever credibly threaten to switch CRSs, and each CRS remains essential to any airline seeking to reach the customers of that system's travel agents.

Nothing has happened since the Department's last significant review and revision of Part 255 in 1992 that warrants the abandonment of the CRS Rules. But as Orbitz (and many others) have explained, the CRS Rules have not been an unqualified success. In some respects they have regulated too much, and in some they have regulated too little. The basic concept and principal provisions of the CRS Rules should be retained. But the Department should not adopt proposals

made by other parties which would undercut instead of serve the purposes of the Rules. In addition, the Department should adopt some refinements and clarifications of Part 255, as discussed below.

B. The CRS Rules should clearly apply to all CRSs that enter into contracts with travel agents.

Part 255 can protect consumers and competition only if it clearly applies to every CRS that enters into contracts with travel agents in the United States. But it is debatable whether the CRS Rules today cover the largest CRS in the world – Sabre, which is responsible for 46% of all CRS bookings in the United States, and which has more travel agents under contract than any other system. The applicability of the CRS Rules to Sabre now hangs by the thin, and always arguable, thread of whether Sabre is marketed by one or more airlines. Although to date Sabre has stated that it is now complying with Part 255, there is no clear guidance as to whether Sabre would, in the future, argue that it was no longer marketed by an airline and therefore was no longer subject to the CRS Rules.¹⁷ And if Sabre is no longer subject to the CRS Rules, it could at any time – especially once this rulemaking is completed – re-introduce discriminatory booking fees, display bias, ten-year agent contracts with rollover clauses, and other long-since prohibited practices.

As discussed above, there is no reason that it should be open to debate whether Sabre is and will continue to be governed by the CRS Rules. The standard for the applicability of the CRS Rules should no longer be just whether a carrier owns, controls, operates, or markets a

¹⁷ The position that Sabre, if marketed by one or more airlines, is clearly covered by the CRS Rules, is itself unfortunately arguable. The nearly-forgotten MARS Plus CRS, which had been marketed but not owned by airlines such as Eastern, was determined by the CAB to be exempt from the CRS Rules. See U.S. Civil Aeronautics Board, in consultation with the U.S. Department of Justice, Report to Congress on Airline Computer Reservation Systems,

CRS. Section 255.2 should extend the CRS Rules to all CRSs that enter into contracts with travel agents. As has been discussed, because every CRS requires its agents to enter into long-term contracts, it is virtually impossible, or at least prohibitively expensive, for most agents to switch CRSs. All of the threats that CRSs pose to consumers and competition therefore exist regardless of who owns them.¹⁸

In the prior rulemaking, the Department stated that it had seen no evidence that CRSs that are not owned by airlines had the same incentives and ability to “destroy air competition and to injure consumers” as did traditional CRSs. See Computer Reservation System (CRS) Regulations, Notice of Proposed Rulemaking, 56 Fed. Reg. 12586, 12604 (Mar. 26, 1991). Events and developments since then clearly have demonstrated that CRSs’ market power over travel agents and air carriers is not dependent on their ownership. For example, Sabre reportedly continued to dominate travel agents in Memphis after the city ceased to be an American hub, and, in fact, after the CRS ceased to be owned by American, presumably because Sabre had locked so many Memphis agents into long-term contracts. See Comments of the American Society of Travel Agents, at 14.

at 33 (June 1, 1983); Carrier-Owned Computer Reservations Systems, Notice of Proposed Rulemaking, 49 Fed. Reg. 11644, 11667 (Mar. 27, 1984).

¹⁸ In addition, since the mid-1990s most of the bilateral aviation treaties that the United States has entered into or revised have incorporated an annex setting forth “Principles of Non-Discrimination and Competition among Computer Reservation Systems.” The default language of this annex requires that:

All CRSs that are available to travel agents who directly distribute travel information about airline services to the traveling public in either Party’s territory shall ... be obligated to ... operate in conformance with the CRS rules that apply in the territory where the CRS is being operated.

(Emphasis added.) If the Department does not revise Part 255 such that it clearly applies to Sabre and other CRSs without airline ownership, the U.S. may be in default of its treaty obligations to at least 40 countries, including: Aruba, Austria, Bahrain, Brunei, Chile, Costa Rica, the Czech Republic, Denmark, El Salvador, Fiji, Finland, France, Gambia, Germany, Ghana, Guatemala, Honduras, Iceland, Italy, Jordan, Luxembourg, Macau, Malaysia, Namibia, the Netherlands, New Zealand, Nicaragua, Norway, Oman, Peru, Portugal, Qatar, Singapore, Slovakia, Sweden, Switzerland, Taiwan, Tanzania, and Turkey.

Moreover, the CRSs have continued to abuse this power, such as by imposing excessive costs in the sale of tickets (costs ultimately borne by consumers), preventing the entry of any new competition, and denying choice to agents. As discussed above, Sabre is now strong-arming the airlines to offer their Internet fares through the CRS, backed up by the threat of a 7% increase in its already excessive booking fees if they do not. Travelocity, the Internet arm of Sabre, although not itself a CRS, has similarly demonstrated how a booking system not owned by an airline can have an incentive to distort airline competition and to injure consumers. By selling its ability to “swing market share” to airlines, as well as by omitting information from its displays that is available on Sabre, Travelocity has amply demonstrated that airline ownership is not the source of its economic incentive to distort competition.

This proposed expansion of the CRS Rules would not affect existing online travel agents, because they do not enter into contracts with their users. Anyone – including travel agents – is free to visit Orbitz, and then to surf to another website, to compare the routes and prices on offer. Orbitz is not aware of any Internet travel websites that currently enter into binding contracts with travel agents. However, if a site were to require travel agents to enter into a contract like those today used by CRSs, then the site would be subject to Part 255.

C. The CRS Rules should protect travel agents from exploitative and anti-competitive contract terms.

Despite the requirements of the CRS Rules as enacted in 1984 and amended in 1992, the CRSs have continued to find ways of preventing travel agents from readily switching to another CRS. As a result, the CRSs have succeeded in suppressing the competition among CRSs that would benefit everyone else – consumers, travel agents, and airlines. Therefore, the Department should expand the list of contract terms that Part 255 prohibits to protect agents from abusive

CRS practices. The Department's objective should be to provide agents with ongoing market choice as to which CRS they install and which CRS they use to make their next booking.

The comments filed by ASTA in 1989 and in 1997 continue to provide a general blueprint as to how the Department should revise the CRS Rules:

- The Department should reduce the maximum term for contracts between travel agents and CRSs, and prohibit the practice of imposing multiple contracts with overlapping expiration dates on agents. “[A] reduction in the maximum contract terms ... will provide an environment in which competition among the remaining vendors will be effective in curtailing abuses.” Comments of the American Society of Travel Agents, Docket 46494, Nov. 20, 1989, at 22. Orbitz specifically recommends that agent contracts not be allowed to exceed one year, and that once a CRS has begun a contract term with an agent, the CRS may not through any sleight-of-hand extend the agent's commitment to that CRS, through that contract or through another contract, beyond that one-year term. In other words, at least once a year, agents should be in a position to choose the CRS that best meets their needs and offers them the greatest value. Agents would find themselves courted and compensated by CRSs at levels hard to imagine in today's world of highly restrictive contracts.
- The Department should prohibit productivity pricing clauses in CRS contracts with travel agents that go beyond a simple reflection of productivity and become instead de facto minimum use clauses, which have been prohibited since 1992. “Minimum use provisions deter the installation of competing systems. ... The

decision as to which CRS system to use, and how much use to make of it, should rest with the independent judgment of the travel agent.” Id. at 24. However, the DOT should not prohibit productivity pricing to the extent that it reflects the actual savings and efficiency of an increased volume of transactions by an agent.

- The Department should prohibit liquidated damages clauses that have been used to impose enormous penalties for the early termination of contracts between travel agents and CRSs. Because courts usually uphold such clauses under state contract law, without regard to their anti-competitive purpose and effect, these clauses can trap agents into a contract with a CRS that is no longer the best system for the agent’s needs. Moreover, liquidated damages clauses typically reflect the profits a CRS can make through its market power, and not the revenue that it reasonably could expect to earn in a competitive market. See id. at 26-27.
- The Department should prohibit CRSs from adopting unreasonable limits on the use of third-party hardware or software with any computer. See id. at 30. As described above, the third-party equipment rule reportedly has had perverse results: CRSs ensure that most agents use CRS-provided equipment, in order to make sure that third-party vendors do not have an opportunity to compete for agents’ business. See, e.g., Comments of Reed Elsevier, Inc., at 4-5 (Dec. 9, 1997); Comments of the Large-Agency CRS Coalition, at 3-4 (Dec. 9, 1997). Most travel agents now use ordinary computers and not CRS-specific terminals, so arguments about the risk of compatibility problems with third-party products are now mostly moot. See, e.g., Comments of America West Airlines, at 17 (Dec.

9, 1997). In addition, the Department should prohibit CRSs from marketing software tools that reintroduce bias, a practice allowed by Part 255.9 but in direct conflict with the intent of the display bias rule.

- The Department should deal with the issue of marketing and booking data. As described above, Part 255.10 is one of the CRS Rules that has not worked as intended. Although Orbitz is not a CRS, its business model removes any temptation to misuse this data; marketing and booking data will belong to the carrier on which a booking is made, not to Orbitz. In order to protect competition, Orbitz recommends that the Orbitz policy on data be applied as a rule to all CRSs. Similar concerns have been raised before the DOT by ACAA, although ACAA has proposed only to limit the release of data, and not convey data ownership to the airlines. See Comments of the Air Carrier Association of America, at 9 (Aug. 25, 2000).
- While there has been substantial change in the automated distribution arena since the last CRS rulemaking, the importance of travel agents and the systems they use is not about to decline. Therefore, Part 255 will be needed well into the future, and Orbitz recommends that the CRS Rules be extended for at least five years. In addition, the Department should be committed to continuously monitoring the developments in the CRS and travel industries. See Comments of the American Society of Travel Agents, Docket 46494, at 35-36 (Nov. 20, 1989).

These long overdue revisions to the CRS Rules will encourage competition among CRSs for the business of travel agents, instead of allowing CRSs to continue to dictate terms to agents. Because the market power of the CRSs with respect to travel agents appears unlikely to be directly challenged in the foreseeable future, government regulation in this area is well justified and will be needed for many years to come. These revisions will benefit consumers by freeing both traditional and online agents from the worst continuing abuses of the CRS oligopoly.

D. CRS rules that have not worked as intended, such as the mandatory participation rule, should be fully reconsidered.

As described above, some provisions of the CRS Rules have not worked as intended, and a few actually have harmed consumers and competition. The mandatory participation rule, Part 255.7, is perhaps the most dramatic example. Drafted to deal with an apparently rare problem, it has eased the concern that airlines that own CRSs might undercut other systems by reducing their participation in the latter, but at the same time the rule has eliminated any possible leverage that most carriers might have had over excessive CRS booking fees. “The Department is faced with two competing concerns in this proceeding. ... At this stage of regulation ... concern about inter-CRS competition must be subordinated to the more important goal of restraining CRS monopoly power.” Reply Comments of Trans World Airlines, Feb. 3, 1998, at 11.

The most elegant solution to the dilemma posed by the mandatory participation rule, especially in light of the declining airline ownership of CRSs, would be for the Department to simply repeal the rule. The elimination of Part 255.7 would restore the theoretical possibility that airlines might rediscover at least a minimal amount of leverage with which they could negotiate the terms and conditions of their participation in CRSs. An “airline’s best market mechanism to prod the CRSs to act [more responsibly to market forces is] the real threat of a

downgrade on only the offending CRS vendor.” Comments of the U.S. Department of Justice, Docket OST-96-1145, Sept. 19, 1996, at 8. At the same time, the Department could monitor whether any carrier-owners subsequently refuse to participate in other CRSs under circumstances that could only be explained by an anti-competitive intent. It is likely that the Department will find that even though it was concerned in 1992 that such conduct might occur, the absence of the mandatory participation rule does not mean that such conduct would occur. In the unlikely event that such conduct does occur, the Department could address it pursuant to 49 U.S.C. § 41712, and the Justice Department could address it pursuant to the Sherman Act.

But regardless of exactly how the Department addresses the problems of the mandatory participation rule,¹⁹ Orbitz urges the Department to carefully review both that rule and all other provisions of the CRS Rules that have failed to serve their intended purposes. The Department ultimately should adopt and continue only those rules that it is confident will actually benefit consumers and competition.

E. Because of the key differences between the CRS industry and the Internet, the public interest requires continued and strengthened rules in the CRS arena, but best can be served by market forces in the Internet arena.

For two decades the key to the issues, and to the anti-competitive problems, surrounding the use of automated systems in the distribution of airline tickets has been the binding of the users of those systems by highly restrictive contracts, and the resulting impossibility for any airline to be able to credibly threaten to withdraw part or all of its offerings from that CRS in order to create a situation in which it can credibly negotiate with the system. That continues to be the key anti-competitive problem of CRSs today.

¹⁹ Northwest has proposed, in the alternative, that system owners be required only to participate in other CRSs at the basic level. See Reply Comments of Northwest Airlines, at 2-3 (Feb. 3, 1998).

And at the very beginning of the debate about CRSs in 1983, it was the key problem on which the Justice Department built its case for the regulation of anti-competitive CRS practices.

Conventional indices of market share do not fully reflect the market power of each CRS vendor, however. A CRS with a small national share and a modest share of the CRS placements in a particular city may have substantial market power in the sale of CRS listings to air carriers. The reason is simple: even a major national airline would find it very costly not to be listed in any CRS that is used exclusively by a sizeable portion of the travel agents in a city that the airline serves. As a result, a CRS used exclusively by travel agents that account for, say, one-fifth or one-sixth of the domestic travel revenues in a metropolitan area – and every CRS has that large a block of agents in some markets – could have market power.

U.S. Department of Justice, Comments and Proposed Rules of the Department of Justice, Docket CAB-41686, at 4 (Nov. 17, 1983).

The Department has recognized the same core reality:

Insofar as agents are the primary distribution mechanism, and CRS's are their information source, if a carrier's information does not appear in the computer display, that carrier will be at a significant disadvantage vis-a-vis its competitors. The agent will not know of its services and will not offer them to the public as a travel option. ...

Many parties have complained that the combined effects of long-term contracts, "exclusive use" provisions, excessive liquidated damages clauses, and below cost pricing are to impede entry into the CRS industry and expansion by small vendors. These practices are employed to get the agent onto the owner's system and keep it there. Once on, any carrier cannot avoid dealing with the CRS owner if it wants to communicate with the agent. If the CRS owner has enough agents signed on, the carrier cannot avoid dealing on the CRS owner's terms.

U.S. Department of Transportation, Carrier-Owned Computer Reservations Systems, Notice of Proposed Rulemaking, Docket CAB-41686, 49 Fed. Reg. 11644, 11646, 11664 (Mar. 27, 1984).

The central issue with automated distribution systems has always been whether any individual airline could get enough bargaining leverage out of the threat of withdrawing some or all of its fares and/or schedules to induce normal market bargaining with the CRS over fees, displays, and other issues. If each airline has that leverage, these issues can be left to the

marketplace. If each airline does not, anti-competitive practices, monopoly power, and market distortions result, and we are left to hope, often in vain, that regulation can substitute for the missing market forces.

In issuing the first rule on booking fees in 1984, the CAB made it clear that its decision not to impose a reasonableness rule on booking fees, in addition to a non-discrimination rule, was based on a hope (false, as it turned out) that at least the largest airlines would have the ability to induce the largest CRSs to bargain:

In proposing and adopting only a price discrimination rule, we are not finding that vendors should have unfettered freedom to charge their air transportation competitors excessive fees. We need not determine the limits of that freedom here. Rather, we anticipate that the bargaining power of some participating carriers, combined with a non-discrimination requirement, will generally hold fees close to reasonable levels. ... United has indicated that some carriers are important enough to agents to give those carriers substantial bargaining power, and DOJ has also noted its view that a properly constructed rule would permit us to rely on bargaining power of larger CRS customers to hold all fees to reasonable levels

U.S. Civil Aeronautics Board, Carrier-Owned Computer Reservations Systems, Final Rule, Docket CAB-41686, 49 Fed. Reg. 32540, 32552 (Aug. 15, 1984).

Once that rule went into effect, it immediately became evident, however, that the core problem was not remedied. Even the largest airlines did not have the ability to induce bargaining by the CRSs because even the largest airlines could not afford to deny their fares or schedules to any CRS, and the CRSs knew it. The Justice Department quickly concluded that the hopes of the CAB noted above had been dashed:

It does not appear that any major non-vendor airlines possess countervailing power in bargaining with the major CRS vendors. ... [C]arriers must be listed on all the CRS systems that have significant travel agent placements in the markets they serve. The threat of a large carrier refusing to pay a fee on a particular CRS that was even significantly above the competitive level might not be a viable bargaining strategy. The carrier would stand to lose a significant amount of ticket revenue almost immediately from not having unbiased access to a CRS that had even a moderate share of travel

agents. On the other hand, the loss to the vendor of even one of the large non-vendor carriers is not likely to have a significant impact on the CRS vendor in the short term. The vendor can still provide biased information about the non-participating carrier, and any resulting loss of that CRS's desirability with agents will take time.

U.S. Department of Justice, 1985 Report of the Department of Justice to Congress on the Airline Computer Reservation System Industry, at 48 (Dec. 20, 1985).

The debate about CRSs has always been about whether airlines could use access to fares or schedules as leverage to get automated systems to bargain with them about booking fees, display bias, and the like. The entire CRS problem has been, and continues to be, rooted in the fact that, in the case of CRSs, airlines do not have the leverage that they would in a free and open market to induce bargaining. Ordinarily any businessman may "freely ... exercise his own independent discretion as to parties with whom he will deal." United States v. Colgate Co., 250 U.S. 300, 307 (1919). See also Third-Party Complaint of ARTA, Docket OST-96-1995, Order 99-4-19, at 5 (April 29, 1999) (endorsing Colgate principle in airline context). In any market relationship, a key to two-sided bargaining is always that the buyer of goods or services has the option of not buying from that seller, and that the seller has the option of not selling to that buyer. The former option has been missing in the CRS arena, and that has been the root of the CRS market power problem and of the need and justification for CRS rules.

Now comes the Internet and with it a small group of new fares to which the CRSs (and their Internet surrogates) have not – yet – managed to dictate access on their own terms. The largest CRS has taken this as an affront to its market power, and wants the government not only not to challenge its market power, but to actually extend its market power for it by requiring airlines to give CRSs access to this handful of fares, and again deny individual airlines any opportunity to induce bargaining over CRS, or at least CRS-based Internet site, behavior.

But Orbitz, a new entrant to automated distribution systems, is willing to strike a bargain with each airline individually: CRS reforms in return for access to Internet fares. In order for competition to occur, each airline must individually have the ability to make this decision for itself, with respect to any other channel – that’s how two-way bargaining on CRS reforms would come about. However, at least one CRS does not want this practice of two-way bargaining to catch on. Sabre/Travelocity wants the government to confer on them, with respect to the Internet, what has always been the core of CRS market power – airlines which have no choice but to give them access to fares (or eliminate them altogether) and therefore cannot bargain for CRS reforms. If the result here is an end to Internet fares, or their reduced availability to the public, or less savings offered to the public, that outcome would be acceptable to the CRSs.

In short, the Internet has created the possibility of competition, and Sabre/Travelocity wants the government to take that possibility away.

If the government does not agree to do that, what will happen?

There are two possibilities. One is that Sabre/Travelocity, or perhaps other CRSs, will at some point decide to compete, rather than to block competition. They will do that by offering airlines, agents and consumers better search and display technology, less bias, reduced booking fees, more equitable treatment of marketing and booking data, and so on. And each airline would have compelling incentives to accept those arrangements, resulting both in CRS reforms and in wider availability of Internet fares.

The other possibility is that the airlines’ attempt to leverage Internet fares will not prove adequate to induce market bargaining by the CRSs and their Internet surrogates. Internet fares are a very small portion of the overall range of fares — only a fraction of one percent. For all the shouting about Internet fares, that may not be enough to induce the CRSs to change their

practices. And airlines cannot expand the types of fares they put only on their own websites (and/or Orbitz) because to do so would disadvantage them in their core air transportation business (exactly the problem that created the CRS market power problem in the first place). In this outcome, airlines and consumers at least have Orbitz (and any similar new entrants who follow once the technology is demonstrated) offering better information and lower costs.

In either scenario, airlines, consumers, and competition itself would be better off than if the Department were to prohibit even this small portion of all fares from being used to try to create more equitable behavior by automated distribution systems.

In short, the leverage of access to Internet fares may be large enough to get some CRS reforms, or it may be too small to get any, but it certainly will not be too large.

The Internet does not present the same problems as the CRS does, because the user of the Internet is not bound to any one system. He or she, if given a real choice, can vote with his or her feet, or, more accurately, with his or her mouse. And no airline is effectively barred from negotiations. An airline can negotiate with websites for fairer practices or reasonable costs for selling through that site, as some carriers have done with some sites with regard to their Internet fares. The basis of the CRS market power problem, and the justification for the CRS rules, is not present on the Internet.

Furthermore, Internet sales represent such a small percentage of overall air travel sales, particularly compared to CRSs. Today CRSs are the medium for about 80% of all such sales, while the Internet is the medium for about 4%, only about half of which are online agency sales. Even when the Internet reaches, as it is expected to in about four years, 12% of air travel sales (with online agency sales amounting to only half of that figure), the CRSs' position in air travel

distribution will still be in a completely different league from the Internet in general and online agencies in particular.

That is not to say that Internet practices, or competition, are perfect today. Consumers are highly dissatisfied with the quality of the travel information available on the Internet, and justifiably so. Nevertheless, absent regulations barring or inhibiting new competition, new sites such as Orbitz (and undoubtedly others to come) will offer consumers genuinely new and better choices, rather than just the rehashed data of the current CRS-based sites. That new competition will remedy the shortcomings of the Internet sites better than any government rule could.

That is also not to say that the coming of Orbitz will remedy all CRS-related problems. While Orbitz will put some competitive pressure indirectly on CRSs (and directly on CRS-based Internet sites) with respect to booking fees, display bias, and the like, the key source of CRS market power will remain. Particularly in areas such as abusive and anti-competitive travel agent contracts, there is relatively little likelihood that indirect competitive pressures from Orbitz (or others) will materially improve that situation. Therefore, the strengthening of the CRS Rules in certain areas, particularly with respect to travel agent contract provisions, is urgently called for to protect competition and consumers in the face of continuing CRS market power.

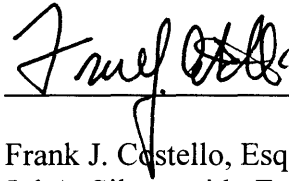
Conclusion

Above all else, the Department should not adopt proposals that would stifle competition and innovation, including the extension of provisions of Part 255 to the Internet, as well as the proposal that Internet fares (which only the low costs of the Internet distribution channel have made viable) must be marketed through all travel distribution channels.

However well-intentioned, the CRS Rules will always be an imperfect remedy in comparison to competition – if only there were competition in the CRS industry. There is now an opportunity, through a variety of new technologies (the Internet, server hardware, innovative independent software) to inject competition into many areas of concern, including display bias and booking fees, most directly with CRS-based Internet travel websites. That potential for new competition is now embodied in Orbitz and is likely to be taken up by others as well, unless the government blocks that potential. However, Orbitz acknowledges that new technology cannot bring new competition to some areas of concern, such as the extent to which travel agents' CRS contracts deny them any ongoing choice among systems. In such areas, the CRS Rules should not only be continued: they should be substantially strengthened.

In sum, the Department's objective in this proceeding should at least be to not take any action which would tend to preclude new competition, because that competition, where it can come into existence, would better protect the interests of consumers and competition than any rule. In other words, the Department should at least do no harm.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Frank J. Costello", is written over a horizontal line.

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EXHIBIT A

ONLINE TRAVEL AGENCIES' AFFILIATIONS WITH THE TOP 10 INTERNET SITES' (Ranking Based on Neilson/Net Ratings' Estimation of the Number of Unique Visitors in July 2000)						
PROPERTY	UNIQUE HOME VISITORS ⁱⁱ	REACH (% of Internet home users)	UNIQUE WORK VISITORS ^{ciii}	REACH (% of Internet work users)	AFFILIATION WITH TRAVEL SITE	EXCLUSIVE
1. AOL Websites ^{iv}	53,051,036	60.15	21,031,727	66.19	Travelocity	Yes; 5 years; Travelocity (TVLY) will pay \$200 million to AOL; AOL will pay TVLY a % of ad revenues. ^v
2. Yahoo! ^{vi}	47,566,989	53.94	21,002,396	66.1	Travelocity	Yes; TVLY will pay at least \$28 million over 3 years; expires end of 2002. ^{vii}
3. MSN and	35,158,084 and	39.87 and	17,456,689 and	54.94 and	Expedia	Yes; 5 year carriage and cross promotion agreement; Expedia will pay Microsoft \$2.0 million in 2000 and \$2.2 million in 2001, plus incentive fees. ^{ix}
4. Microsoft ^{viii}	32,750,239	37.14	17,964,294	56.54		
5. Lycos Network	24,174,846	27.14	12,019,437	37.83	Travelocity	Yes; 2 year agreement expires 9/15/00. ^x
6. Excite@Home	21,568,038	24.46	10,947,874	34.46	Travelocity	Yes; TVLY must pay a minimum of \$11 million; expires 2002. ^{xi}
7. GO Network	18,308,910	20.76	9,614,102	30.26	Travelocity	Preferred provider on the Go Network Travel Center; one year term; TVLY will pay Go Network a % of net revenues derived from GO Network users and the co-branded sites; TVLY must purchase certain level of advertising. ^{xii}
8. About.com	14,333,886	16.25	7,538,170	23.73	Travelocity advertising banner appears throughout the Air Travel section of About.com site. ^{xiii}	Appears to accept ads from other travel sites, but with less favorable placement.
9. Time-Warner Websites	14,163,776	16.06	7,958,742	25.05	CNN properties, which are owned by Time-Warner, link to leisureplanet.com exclusively, ^{xiv} other Time-Warner sites' deals (if any) are unclear.	Exclusive with almost all CNN Properties, including CNN.com, CNNfn.com, CNNISI.com, CNNtraveler.com; 3 year agreement signed 12/99. ^{xv}
10. Alta Vista	13,242,720	15.02	8,031,204	25.28	Trip.com	Yes; \$15 million for 5-year contract signed 4/07/98. ^{xvi}

i In addition to the above-listed alliances, TVLY also has alliances with, among others, the following Internet sites:

- a) Priceline.com (exclusive marketing and customer referral agreement). According to TVLY's press release, "Priceline.com, Travelocity.com Marketing Alliance Launches," 4/10/00, "the two companies will share the largest user base in the Internet travel industry, estimated at more than 22 million." See also Terrell Jones, PhoCusWright Investor Conference, 4/27/00, "Key Partnerships," slide 8 at http://media.corporate-ir.net/media_files/NSD/TVLY/presentations/tvly_000427-01/sld008.htm. According to Media Metrix's estimation, Priceline was the 45th most visited Internet Property, based on the number of unique work and home Internet users for June 2000. (See Media Metrix Press Release, "Media Metrix Releases U.S. Top 50 Web and Digital Media Properties For June 2000 & Reveals Number One Web Sites Within New Categories," 7/20/00, available at <http://www.mediametrix.com/press/releases/20000720a.jsp>.)
- b) Road Runner (3-year alliance which expires 12/20/02). Road Runner will provide TVLY with premier positioning and promotion in its travel-related areas. TVLY will pay Road Runner a fixed amount for each person who visits TVLY directly from the Road Runner service and another fixed amount for each person, directed from Road Runner, who purchases a ticket; expires 12/20/02; renewable upon mutual agreement. (See Travelocity SEC Form 10K405 for fiscal year ending 12/31/99.)
- c) iwon.com. See Terrell Jones, PhoCusWright Investor Conference, 4/27/00, "Key Partnerships," slide 8 at http://media.corporate-ir.net/media_files/NSD/TVLY/presentations/tvly_000427-01/sld008.htm. According to Media Metrix's estimation, iwon.com was the 21st most visited Internet Property, based on the number of unique work and home Internet users for June 2000. (See Media Metrix Press Release, "Media Metrix Releases U.S. Top 50 Web and Digital Media Properties For June 2000 & Reveals Number One Web Sites Within New Categories," 7/20/00, available at <http://www.mediametrix.com/press/releases/20000720a.jsp>.)

ii See Neilsen/Net Ratings. "Unique Home Visitors" refers to the number of individual users estimated to have visited the specified site, through home access to the Internet, in July 2000. The estimates are based on a sample of households that have access to the Internet and use Windows 95/98/NT or MacOS 8 or higher.

iii See Neilsen/Net Ratings. This refers to the number of individual users estimated to have visited the specified site, through work access to the Internet, in July 2000. The estimates are based on a sample of at-work users that have access to the Internet. Individuals that visited a site through an Internet connection at work may also have visited a site through a home connection and would be considered a separate visitor for home use estimation purposes.

iv The AOL websites include AOL's proprietary network, AOL.com, the CompuServe Service, Netscape Netcenter, and Digital City. (See Travelocity SEC Form 10K405 for fiscal year ending 12/31/99.)

v Under the agreement, TVLY is the exclusive travel booking system for AOL for the five years ending 3/31/05, on the United States versions of AOL, AOL.com, the CompuServe Service, Netscape Netcenter, Digital City and, for a one-year term, AOL Plus. (See Travelocity SEC Form 10K405 for fiscal year ending 12/31/99.) In addition, AOL is obligated to place promotions throughout the AOL properties that will permit AOL users to link to TVLY-AOL co-branded sites. See [id.](#)

vi Yahoo! is a minority investor in TVLY. (See Travelocity SEC Form 10K405 for fiscal year ending 12/31/99.)

vii See Travelocity SEC Form 424B3 filed 02/08/00 (Proxy Statement/Prospectus filed in connection with TVLY's merger with Preview Travel). TVLY is the exclusive provider of air, hotel and rental car booking services for Yahoo! (See Travelocity SEC Form 10K405 for fiscal year ending 12/31/99.) See also Travelocity Press Release, "Yahoo and the Sabre Group Team Up to Bring Users Travel Booking Services," 11/10/97, available at <http://svc.travelocity.com/pressroom/pressrelease/0,1090,14|TRAVELOCITY,00.html>.

viii

Microsoft Corp. is an 85% owner of Expedia, Inc. (See <http://www.hoovers.com>, Expedia, Inc. Company capsule.)

ix

See Expedia Prospectus, 11/9/99, at 44 and 59. Under the terms of the partnership, Microsoft will supply Expedia with premium placement on the MSN.com website, the Hotmail email service and the WebTV platform. According to Expedia's Prospectus, Hotmail is one of the largest e-mail systems in the world, and WebTV is one of the largest providers of television-based Internet access. According to Media Matrix's June 2000 data, Hotmail was the leading E-mail service website with more than 20 million unique visitors. (Media Matrix Press Release, "Media Matrix Releases U.S. Top 50 Web and Digital Media Properties For June 2000 & Reveals Number One Web Sites Within New Categories," 7/20/00, available at <http://www.mediamatrix.com/press/releases/20000720a.jsp>.) In addition, MSNBC.com and Expedia jointly produce the travel section on MSNBC.com's site. (See Travel Section, MSNBC.com at http://www.msnbc.com/news/trav-main_front.asp, which has a direct link to Expedia.com.)

x

See Travelocity SEC Form 10K405 for fiscal year ending 12/31/99. Under the agreement, TVLY and Lycos have a co-branded site that is promoted throughout the Lycos Web site. Lycos will display a minimum number of Internet links to TVLY and the co-branded site. TVLY is obligated to make payments to Lycos, as well as pay a portion of commissions TVLY earns through the co-branded site in excess of specified thresholds, and pay Lycos "fees for providing links to [TVLY's] services above specified thresholds." *Id.*

xi

See Travelocity SEC Form 10K405 for fiscal year ending 12/31/99. Excite@Home is a global media company focused on combining leading brand and media with distribution. The company is the result of a merger between Excite, Inc. and @Home Network in 1999. (See Excite@Home Fact Sheet available at <http://corp.excite.com/about/facts.html>). Prior to the merger, TVLY had separate agreements with Excite Inc., a leading Internet search engine provider, and @Home Network. TVLY is the exclusive provider of travel booking services for Excite's Travel Channel (City.Net) in the United States and for the WebCrawler Travel Channel. The agreement with Excite expires in 2002. (See Travelocity SEC Form 10K405 for fiscal year ending 12/31/99.) TVLY is the exclusive travel booking service provider for @Home Network subscribers. @Home is a leading provider of high-speed Internet services via the cable infrastructure. Under the TVLY-@Home agreement, @Home agreed not to create a channel that provides travel information for any of TVLY's direct competitors or to allow any competitor to place any promotional material on @Home Network Web pages on which TVLY is featured. In addition, TVLY committed to pay @Home the greater of a set fixed quarterly rate or a variable rate equal to a portion of TVLY's revenues from advertising on @Home and from the sale of services to @Home subscribers. This agreement expires in 2001. (See Travelocity SEC Form 10K405 for fiscal year ending 12/31/99; *see also* Travelocity Form 424B3 filed 02/08/00, and Travelocity Press Release, "@Home Network Taps the SABRE Group to Deliver a One-Stop Shop for Travel Services," 4/21/98, available at <http://svc.travelocity.com/pressroom/pressrelease/0,1090,39|TRAVELOCITY,00.html>.)

xii

See Travelocity SEC Form 10K405 for fiscal year ending 12/31/99. Go Network (Infoseek) will not sell banner advertising space on the Go Network Travel Center to 3 previously identified competitors of TVLY. The agreement provides that, after March 2000, either party can terminate the agreement upon 90 days notice. In addition, the parties may mutually agree to extend the deal for one year terms. *See id.*

xiii

The "front page" of this section is available at <http://airtravel.about.com/travel/airtravel/mbody.htm>.

xiv

See, e.g., "CNN, Leisureplanet Travel in Circles," The Standard, 12/21/99, available at <http://www.thestandard.com/article/display/0,1151,8406,00.html>. CNN made a \$20 million equity investment in leisureplanet.com and Leisureplanet.com committed to purchase \$30 million in advertising on CNN properties. (See Leisure Planet Press Release, "CNN Newsgroup to take \$20 Million Equity Stake in Leisureplanet as part of Strategic Agreement," 12/20/99, available at <http://leisureplanet.com>.)

xv

See Leisure Planet Press Release, "CNN Newsgroup to take \$20 Million Equity Stake in Leisureplanet as part of Strategic Agreement," 12/20/99, available at <http://leisureplanet.com>.

See Trip.com press release, "The Trip.com and Alta Vista Search Site Sign Exclusive \$15 million five-year deal for Internet travel service," 4/7/98, available at <http://www.trip.com/information/pressroom/article/1,1298,1-1-7,00.html>. Galileo is Trip.com's parent company. (See "Partners of TRIP.com" available at <http://www.trip.com/information/partners/resources/>.)

Prepared August 2000.

EXHIBIT B

Statement of Daniel M. Kasper**LECG****Cambridge, MA****Introduction**

I have been asked by Orbitz to assess and provide comments in this proceeding on a range of economic, competition, and public policy issues that have been raised with regard to electronic distribution of air transportation generally, and with respect to Orbitz in particular. I am currently Managing Director of the Cambridge, MA office of LECG, a firm that specializes in financial and economic analysis. For more than twenty years, my professional activities – as a consultant, as an expert witness on airline matters, as an academic, as an official at the Civil Aeronautics Board, and as a Member of the U.S. National Airline Commission in 1993 -- have been focused on competition, public policy, and economics of the airline industry.

My initial comments review the role and competitive significance of e-commerce both in the U.S. economy generally and in airline industry in particular. They then assess the economic and competitive implications of the services contemplated by Orbitz and close with a review of the probable effects on competition and economic efficiency of alternative public policy/regulatory responses to the emergence of Orbitz and other new entrants in the air travel distribution business.

The Role and Competitive Significance of E-Commerce in the Economy

The advent of Electronic Commerce (or e-commerce) has had a profound effect on business and the economy worldwide. Fueled by the wide availability of increasingly inexpensive computing power and the proliferation of the Internet in general, e-commerce has drastically improved consumer welfare, reduced market frictions, lowered purchasing, marketing and distribution costs, and in many cases, has been responsible for allowing new markets to evolve. E-commerce has forced traditional firms to become more competitive, reduce prices and increase service offerings. Moreover, as new ways of accessing the Internet emerge and both businesses and consumers grow more confident of the security and privacy of the Internet, the impact of e-commerce will only increase.

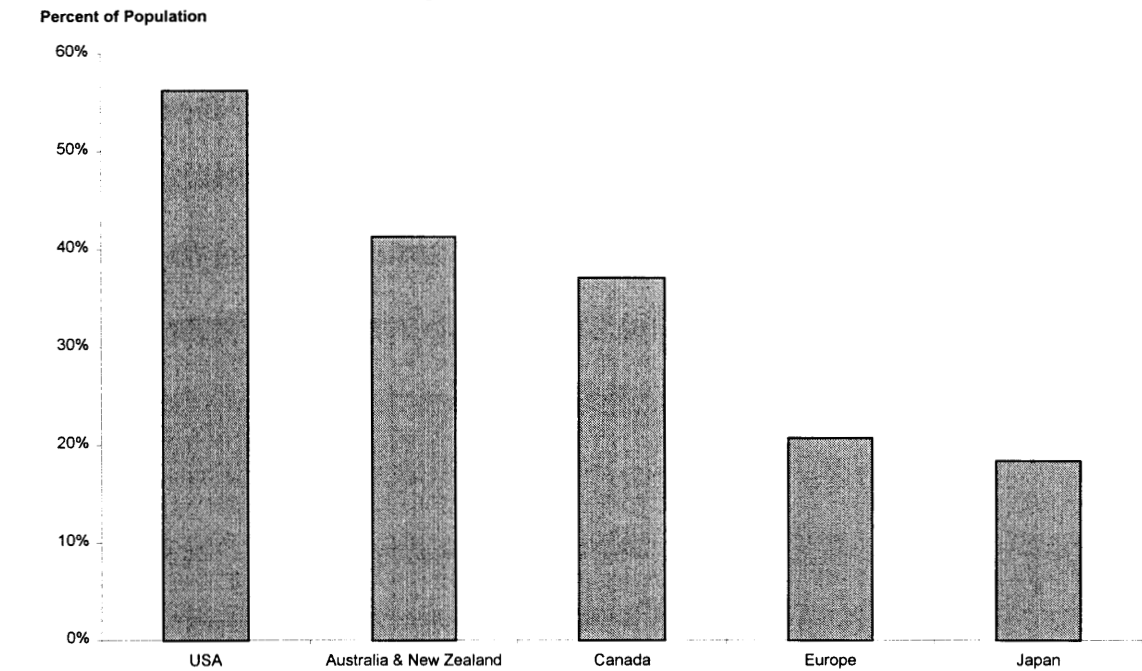
E-Commerce Will Account for Half A Trillion Dollars in Economic Activity in the United States This Year

For the year ending July 2000, e-commerce will account for half a trillion dollars of economic activity in the United States alone.¹ The willingness of U.S. firms and consumers to embrace new technology in general – and the Internet in particular – has made it the global leader in e-commerce. As demonstrated by Figure 1 below, Internet penetration in the U.S. is substantially higher than in other developed countries. Consequently, as shown in Figure 2, even though the U.S. economy accounts for only 23% of the world's output, it accounts for nearly 75% of all e-commerce.²

¹ Source: Forrester Research.

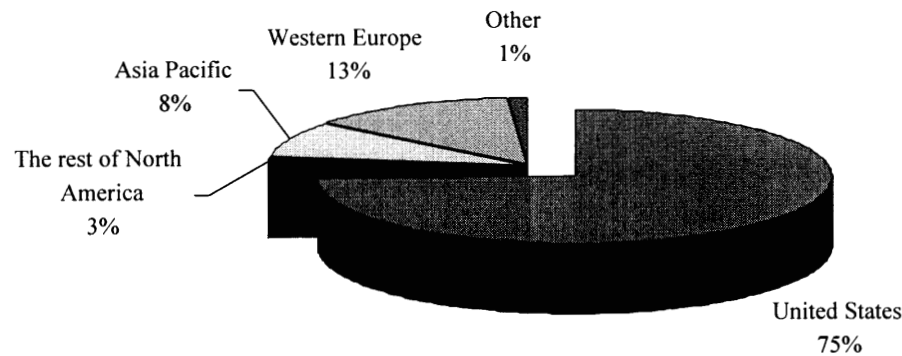
² Sources: Forrester Research, CIA World Factbook,
(<http://www.odci.gov/cia/publications/factbook/index.html>)

Figure 1: Internet Penetration



Source: <http://www.netsizer.com>

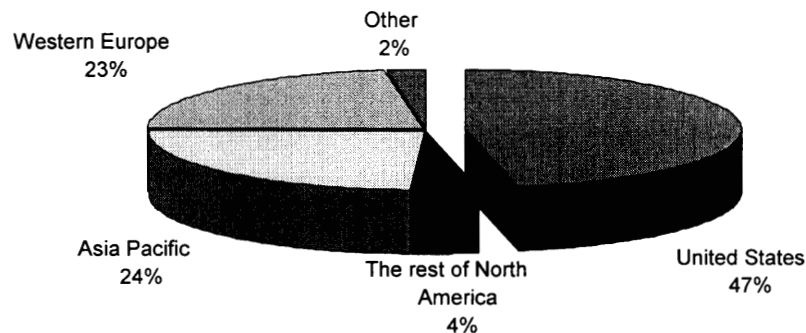
Figure 2: Total E-commerce Sales, 2000



Source: "Global eCommerce Approaches Hypergrowth", Forrester, April 18, 2000

Furthermore, despite the fact that e-commerce is growing faster in other areas of the world, analysts predict the U.S. will still account for nearly half of all global e-commerce in the year 2004.

Figure 3: Total E-commerce Sales, 2004



Source: "Global eCommerce Approaches Hypergrowth", Forrester, April 18, 2000

"Hands off" Regulatory Policy has Been Instrumental in the Success of E-commerce in the U.S

Realizing the potential for enormous growth in both productivity and output from the Internet and E-commerce, the U.S. regulatory bodies decided at an early stage to adopt a "wait and see" approach as opposed to pre-emptive regulation. For example, in 1997, the White House issued "A Framework for Global Electronic Commerce" which supported a non-regulatory, market orientated approach to electronic commerce.

For electronic commerce to flourish, the private sector must continue to lead... Accordingly, governments should encourage self-regulation wherever appropriate and support the efforts of private sector organizations to develop mechanisms to facilitate the successful operation of the Internet... Unnecessary regulation of commercial activities will distort development of the electronic marketplace by decreasing the supply and raising the cost of products and

services for consumers the world over... Business models must evolve rapidly to keep pace with the break-neck speed of change in the technology; government attempts to regulate are likely to be outmoded by the time they are finally enacted, especially to the extent such regulations are technology-specific. Accordingly, governments should refrain from imposing new and unnecessary regulations, bureaucratic procedures, or taxes and tariffs on commercial activities that take place via the Internet.³

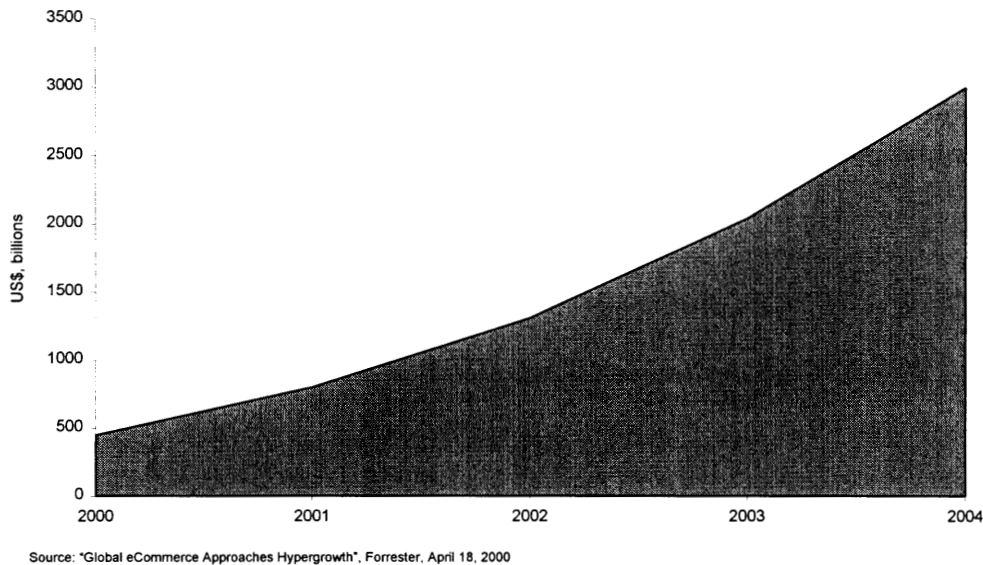
These early decisions have clearly paid huge dividends to consumers, firms and indeed the economy as a whole. Firms have benefited from increased productivity and lower costs, consumers have benefited from lower prices and a greater selection of goods and services, and the economy generally has benefited from increased employment and output, while prices have remained in check.

Business to Business E-commerce Accounts for the Overwhelming Majority of all E-Commerce

E-commerce has traditionally been separated into two main categories: Business to Business (B-to-B) and Business to Consumer (B-to-C). B-to-B e-commerce is broadly defined as sales of goods and services between firms, transacted over the Internet. B-to-B e-commerce is by far the largest segment of the Internet economy, accounting for 92% of all electronic commerce worldwide and \$450 billion of economic activity in the U.S. last year. Indeed, as shown by the following graph, B-to-B e-commerce is predicted to grow at a compound annual rate of 61% and by 2004 will account for 25% of national GDP.⁴

³ "Framework for Global Electronic Commerce." The White House, July 1, 1997.

⁴ Source: "Global eCommerce Approaches Hypergrowth", Forrester, April 18, 2000

Figure 4: U.S. B-to-B E-commerce

The success of e-commerce generally – and B-to-B e-commerce in particular – stems from its ability to make markets more efficient in an economic sense. B-to-B e-commerce has been successful in creating more efficient markets by reducing market risks caused by informational asymmetries and by adding more liquidity to markets. Added liquidity is a result of an electronic market’s ability to aggregate buyers and sellers at a very low cost, especially when they are spread out across a large geographic area. A more liquid market tends to drive prices closer to costs, which in turn forces sellers and producers to become more efficient. For example, a firm’s procurement department can use B-to-B exchanges to instantaneously receive and compare price quotes from hundreds or even thousands of potential suppliers. E-commerce marketplaces also have the ability to diffuse information more efficiently. Reducing asymmetric information in markets plays an important role in making them more efficient since it reduces the chance of market failure (i.e., the classic “lemons” problem) by reducing risk. For example, B-

to-B exchanges often provide escrow and quality verification services in addition to dispersing information regarding buyer and seller reputations. Finally, transaction costs for both buyers and sellers are typically very low when conducted via e-commerce, which adds liquidity to markets and makes them more efficient.

Business to Consumer E-commerce

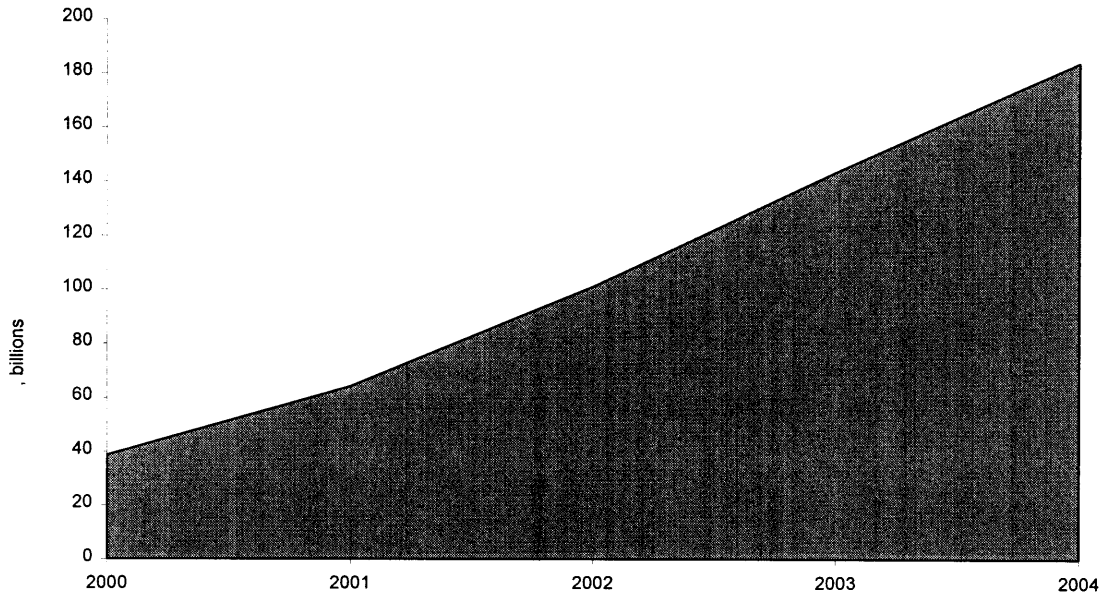
B-to-C e-commerce is defined as sales between firms and consumers transacted over the Internet, for example, someone buying a book from Amazon.com. B-to-C e-commerce sales were \$18.8 billion in the first half of 2000, or 1.2% of all retail sales.⁵ The following table shows the main B-to-C categories of goods and services:

Table 1: U.S. B-to-C Spending by Category July 2000	
Airline tickets	17%
Books, music and videos	10%
Hotel reservations	10%
Computer hardware and software	13%
Consumer electronics	6%
Apparel and Footware	5%
Car rental	5%
Toys/Videogames and sporting goods	5%
Office supplies	4%
Food/beverages	3%
Health and beauty	3%
Furniture, home décor	3%
Jewelry	2%
Tools, hardware, garden supplies	2%
Appliances	2%
Flowers	1%
Other	9%
Source: NR/FR Forrester Research	

⁵ Sources: Forrester Research and the Bureau of Labor Statistics.

B-to-C e-commerce in the United States is expected to grow at compound annual rate of 48% and will reach \$184.5 billion by 2004, accounting for 4.3% of all retail sales.⁶

Figure 5: U.S. B-to-C E-commerce



Source: "Global eCommerce Approaches Hypergrowth", Forrester, April 18, 2000

The evolution of B-to-C e-commerce has benefited consumers in a number of ways. First, since price information can be updated and consolidated almost instantaneously from sellers throughout the country (and indeed the world) – vigorous price competition can be realized if such information is provided in an unbiased fashion. When consolidated and displayed fairly, this product and price information has the effect of driving prices toward the sellers' costs. Secondly, e-commerce allows consumers to purchase goods and services from outside their geographic area giving them a much wider choice of products and services. Thirdly, consumers often benefit from the lower distribution costs

⁶ Sources: Forrester Research and the Bureau of Labor Statistics.

of transacting online in the form of lower prices or other value added features and services. For example, airlines typically offer additional frequent flyer miles or percentage discounts to consumers who purchase tickets via their own websites. Finally, e-commerce has afforded consumers the ability to allocate their time more efficiently, since it allows them to purchase goods and services when it is most convenient for them.

Consumer to Consumer E-commerce

A third, less frequently cited form of electronic commerce is Consumer to Consumer (C-to-C). Examples of C-to-C e-commerce include Internet hosted auctions conducted by companies such as E-bay or U-bid, where individuals may buy and sell personal belongings. Although at first glance, one might think that the volume of goods being sold by such methods is small, E-bay alone has conducted over 60 million auctions since 1995 and in the second quarter of 2000 conducted auctions valued at over \$1.3 billion.⁷ Added security features, such as the ability of individuals to accept credit card payments, have helped to fuel the rapid growth of this type of e-commerce.

New and Faster Ways of Accessing the Internet Will Increase the Role of E-Commerce

The overwhelming majority of transactions conducted over the Internet are performed through personal computers or terminals (known as thin clients) connected either via traditional dial-up services, through an institutional (corporate) local area network (LAN) or via various broadband methods such as digital subscriber lines (DSL) or cable modem. Traditional dial-up methods of accessing the Internet are notoriously slow, which has undoubtedly hampered the growth of B-to-C e-commerce. As broadband access to the

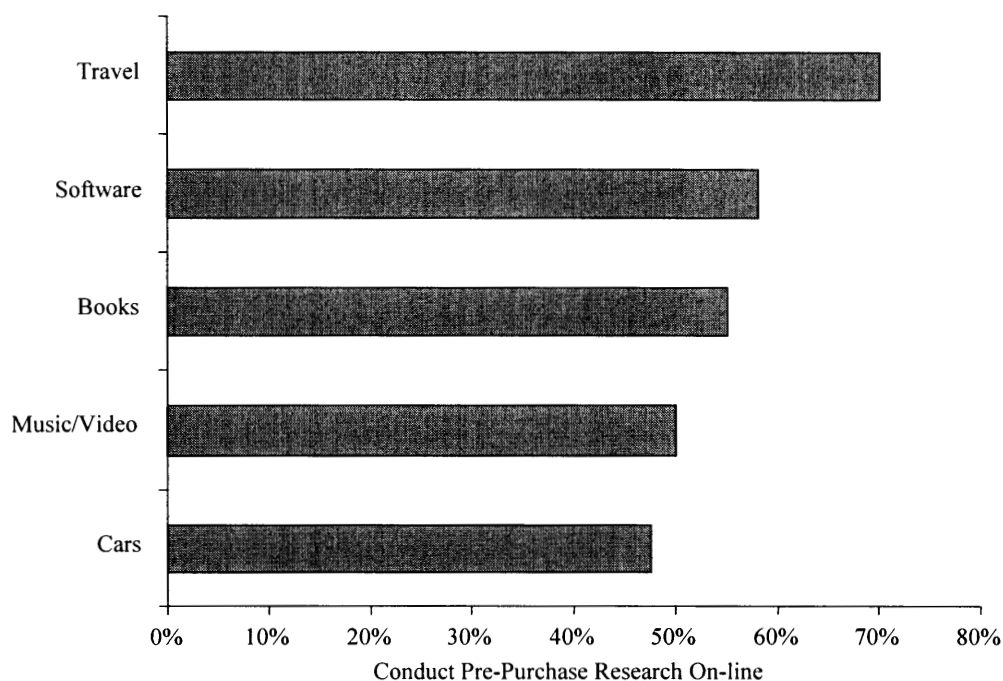
Internet becomes more affordable and widely available, merchants will be able to provide richer content regarding items they wish to sell, and hence, reduce the gap between the “virtual” and “actual” shopping experience. Furthermore, emerging technologies such as wireless access to the Internet will continue to fuel additional sources of growth for e-commerce.

The Role and Competitive Significance of E-commerce in the Aviation Industry

As noted in Table 1 above, airline tickets account for the largest segment of B-to-C e-commerce. Not only do consumers spend more on airline travel than any other category, they spend more time researching travel than any other topic, as shown by the following figure.

⁷ Source: <http://pages.ebay.com/community/aboutebay/overview/benchmarks.html>.

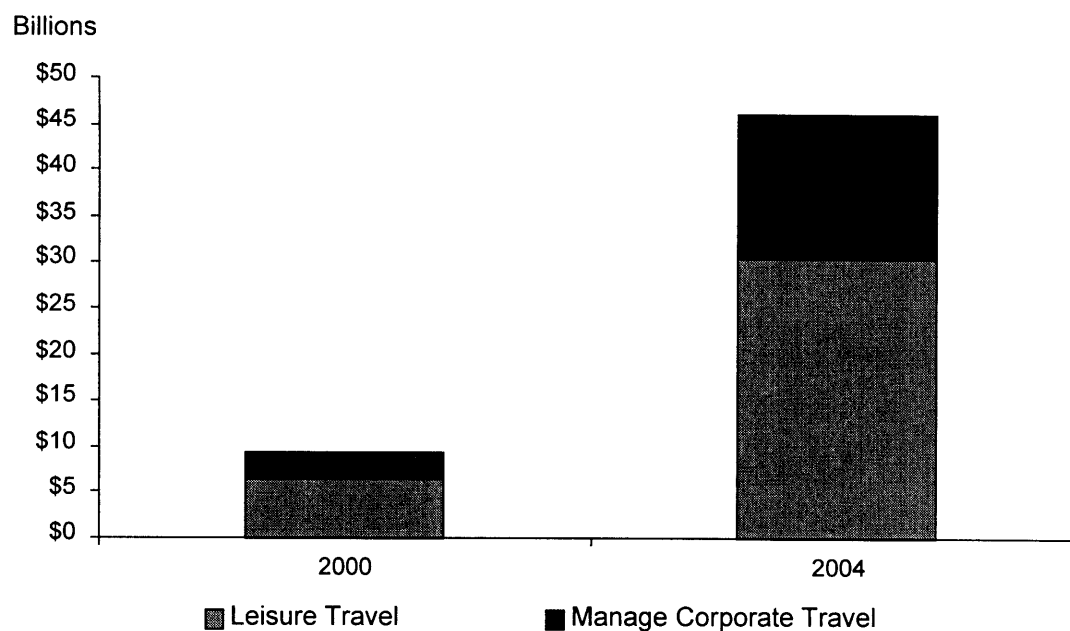
Figure 6: More Internet Users Research Travel On-Line than Any Other Product



Source: Jupiter Communications

In addition to the \$6.4 billion of travel services purchased online by consumers in 2000, businesses will procure \$2.8 billion of travel services online in 2000 and this amount is expected to grow to \$15.7 billion by 2004.⁸

⁸ Source: "Sabre Buys a \$757 Million Lifeline: GetThere," The Forrester Brief, Forrester Research, September 8, 2000.

Figure 7: Online Travel Purchases

Note: 2000 leisure travel is a Forrester estimate for 1999.

Source: Forrester research

It is no coincidence that air services constitute one of the largest segments of the Internet economy. The informational demands required to sell airline services are enormous. Indeed, it is estimated that any given trip purchased by a consumer must be selected from a set of over 1 billion possible itineraries. Combined with the perishable nature of airline services, these informational requirements have often resulted in market inefficiencies – for example, the inability to coordinate potential passengers and airlines to create a market for distressed inventory (excess seats which are still available shortly before the day of a scheduled flight's departure).

Some Background on Airline Ticket Distribution

As airline travel grew more popular during the 1960's, so did the complexity and amount of data required in order to provide airline services. To keep track of all the information required, airlines set up internal reservation systems which tracked their seat availability and linked each seat sold to a passenger record. In 1962 American Airlines, with the help of IBM, was the first airline to develop a computerized reservation system (CRS), known as SABRE. However, it was not until 1976 that a CRS could be used to book tickets on one of numerous participating airlines. As CRSs became more powerful, they grew to become the predominant means by which airline tickets are booked, and today account for nearly 80% of all airline ticket bookings⁹.

Airline Distribution Costs

Today, airline distribution costs account for as much as 20% of an airline's operating expenses.¹⁰ The single largest distribution cost is a travel agent's commission, currently about 5% of a ticket's price.¹¹ Other distribution costs include ticket processing fees – costs related to the currency which traditional airline tickets are printed on – in addition to credit card and CRS booking fees. CRS booking fees are paid based on the number of segments on a given itinerary. Thus, based on a \$3.54 CRS booking fee per segment, an advance purchase roundtrip ticket involving a connection in both directions costing \$300

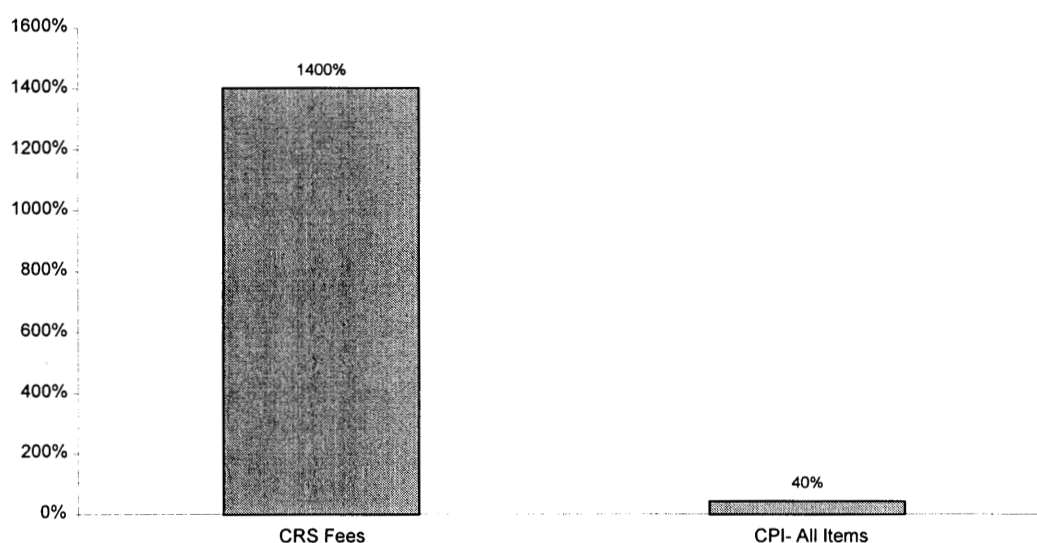
⁹ "Airlines: Reshaping the Industry's Business Model", Merrill Lynch, April 8, 1999.

¹⁰ "Airlines: Reshaping the Industry's Business Model", Merrill Lynch, April 8, 1999.

¹¹ Base travel agent commissions i.e., without overrides. Commissions are also subject to caps, currently averaging around \$50 for domestic roundtrip tickets and \$100 for international roundtrip tickets. Source: "Northwest Airlines and KLM Announce Changes to Commission Structure", October 11, 1999, www.nwa.com and "United Airlines Cuts Travel Agent Commissions", October 7, 1999, www.webtravelnews.com.

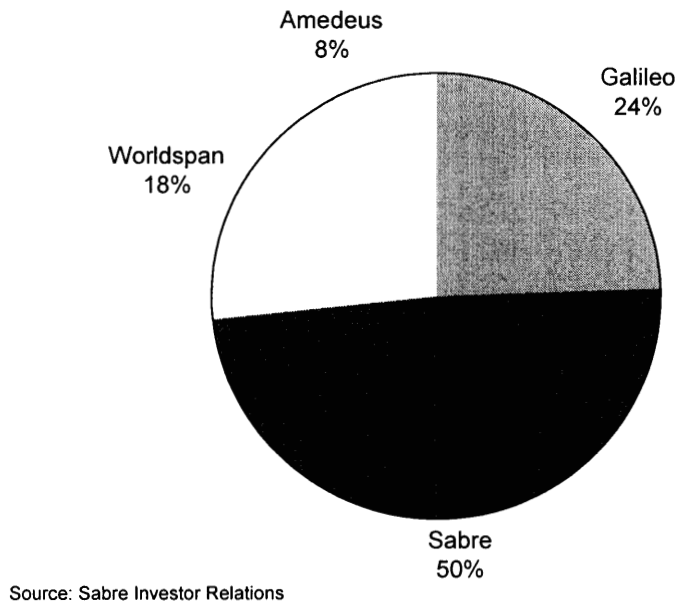
would generate \$14.16 in CRS fees, or 4.72% of the ticket's cost.¹² It is noteworthy that, notwithstanding a steep and secular decline in the cost of computing power, CRS booking fees have consistently increased as the market for CRS services has become increasingly concentrated.¹³

**Figure 8: Growth in CRS Fees vs. the CPI
1983-1999**



Source: Bureau of Labor Statistics and Testimony of Jeffery G. Katz before the U.S. Senate Committee on Commerce, Science and Transportation, July 20, 2000

¹² Kenneth Mead testified that the CRS booking fee per segment is \$3.54. "Internet Sales of Airline Tickets", Statement of the Honorable Kenneth M. Mead, July 20, 2000, CR-2000-111

Figure 9: U.S. CRS Market Share

The Evolution of Airline E-commerce

Propelled in part by the widespread adoption of computer technology and the Internet by the public and the fact that CRS providers have steadily increased booking fees despite the advances in computer and telecommunications technologies, airlines have increasingly sought to use the Internet and other new technologies to increase the number of channels by which they sell their services, thereby lowering their distribution costs. In November 1995, Alaska Airlines became the first carrier in the U.S. to sell tickets via its own Internet site and today, every major airline operates an Internet site on which

¹³ The dramatic decline in computing costs has been well documented. For example, the cost per million of

passengers can book tickets directly. These new technologies have helped airlines reduce costs and manage the ever increasing amounts of data required to operate large networks. Moreover, in many instances, combinations of new technologies have helped airlines to reduce the market inefficiencies related to the perishable nature of their product. For example, airlines are now able to use the Internet to sell their distressed inventory through their own “last minute” electronic fares. The Internet enables airlines to market their distressed inventory almost without cost through direct e-mail to passengers interested in spontaneous leisure travel. Furthermore, because e-fares avoid travel agency commissions and CRS booking fees, it costs substantially less for an airline to book an electronic ticket via its own website compared to a traditional ticket booked through a travel agent. These economies make it economically feasible for the airline to offer last minute tickets at a price low enough to attract such discretionary travelers. The Internet has also allowed airlines to distribute services through a number of other channels such as Priceline.com, which sold 1.25 million tickets in the first quarter of 2000.¹⁴

Since airlines do not have to pay travel agent commissions, CRS booking or ARC processing fees for tickets booked through their respective websites, they have a clear incentive to sell as many tickets as possible through this channel. Nevertheless, online purchases through airline websites account for only a small proportion of all ticket

instructions per second (MIPS), a standard measure of computer processing efficiency, has fallen from \$480 in 1978 to \$4 in 1995. (www.neweconomyindex.org)

¹⁴ Source: Equity Research, Priceline.com. Prudential Securities, April 24, 2000.

sales.¹⁵ This is because the overwhelming majority of travelers prefer to make plans via a travel agent, either traditional or online. Travel agents not only provide travelers with the ability to search across multiple airlines, they typically save time and provide one-stop shopping for other services such as hotels and rental cars.¹⁶ Unfortunately, the online travel agent services business has become highly concentrated in just a few years. As the following table shows, Travelocity (owned by Sabre) and Expedia (owned by Microsoft) together account for over 60% of all online travel agency bookings.

Table 2: 1999 Online Travel Agency Market Share

Travelocity/Preview Travel/ITN.net	39%
Expedia/Travelscape	24%
Priceline.com	10%
Cheap Tickets	4%
Others	23%

Source: PhoCusWright

Despite the fact that online travel agencies embrace many new cost reducing technologies such as electronic ticketing, they still rely on a few CRS systems that are costly, have technological limitations and are hampered by well-known software biases. These biases tend to limit the ability of travel agents (both traditional and online) to find the lowest available fare on a given routing. Consequently, in many cases consumers have not been able to realize the full benefit of vastly improved technology when they book airline tickets online.

¹⁵ For example, in 1999 US Airways and Continental booked 6% and 3.8% of their tickets on their respective websites. Low fare airlines typically book a larger percentage of their tickets via their websites. For example, Southwest alone has sold over \$1 billion of tickets via their website and expects to book 30% of its tickets online this year.

¹⁶ Some airline websites now list flights on competing carriers and offer additional services such as hotel and rental car booking.

Orbitz Will Bring New Technology – and New Competition – to the Distribution of Air Transportation

Orbitz offers the first airline reservation search engine designed to take full advantage of the enormous advances in computing power and software. Thus, whereas the older software used by traditional CRSs eliminates the overwhelming majority of itineraries from consideration before they are checked for prices, Orbitz software compares prices for up to 1 billion different itineraries and then returns the lowest available fares and best itineraries to the user, free of any bias in selection or display. Thus Orbitz fills an important niche for both travelers and travel agents seeking comprehensive and unbiased searches, i.e., without the shortcomings and biases of traditional CRSs.

In addition, Orbitz intends to provide an equally critical service for airlines (and their customers) by helping to lower airline distribution costs. As discussed previously, CRS fees paid by airlines have increased sharply – some 1,400 per cent since 1983¹⁷ -- despite the steep and rapid decline in the cost of computing over that same period. In light of the Department's experience regulating CRSs, these results should come as no surprise to DOT. Indeed, every time the Department has reviewed CRSs, it has concluded that these systems must be subjected to regulation by the Department in order to prevent the abuse of their inherent market power.

In an important sense, then, Orbitz can be understood as simply an organizational vehicle for harnessing the advances in computing and software to reduce distribution costs and to reduce the dominant role currently enjoyed by CRS vendors. It seeks to accomplish this

¹⁷ See Figure 8, *supra*.

reduction in costs by rebating an amount equal to some portion of the booking fees each airline participant paid for bookings through Orbitz – that is, by competing against other CRS-based distribution channels on the basis of price. In addition to directly reducing distribution costs, by creating a new distribution alternative, Orbitz will thus help to break the stranglehold on airline distribution currently enjoyed by the existing CRSs and provide an important new source of competition to the dominant, established on-line agencies.

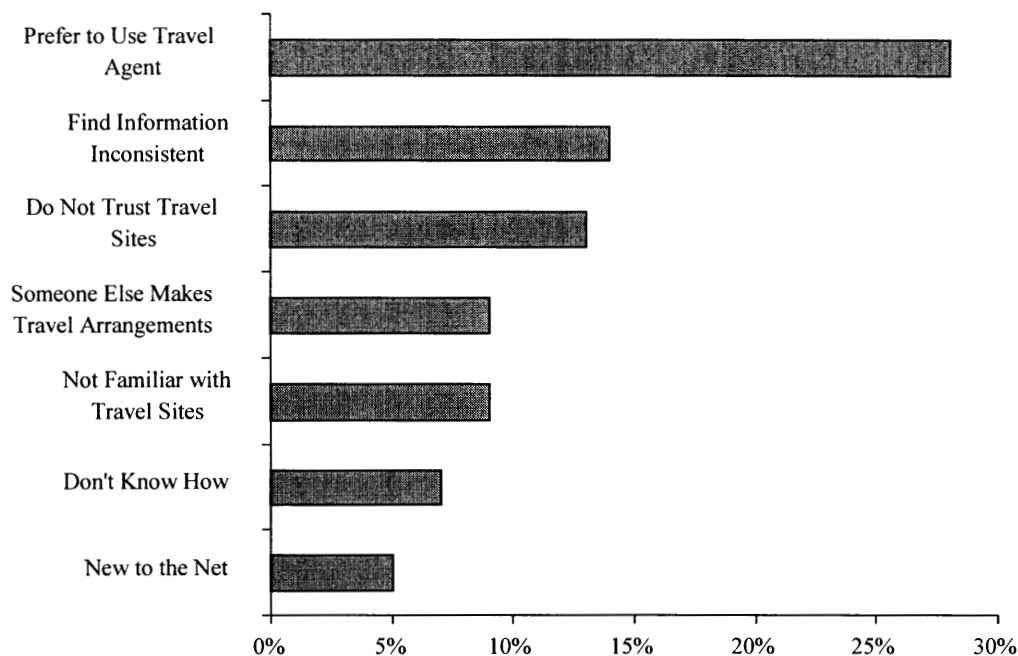
Access to All Public Fares Is Central to Orbitz's Strategy and Success

In order to attract sufficient business from users to become economically viable, however, Orbitz's strategy requires that it offer unbiased access to *all* publicly available fares, including the tiny percentage of fares currently offered by airlines only on their individual websites. In return for providing Orbitz with access to 100% of its publicly available fares rather than the 99.9% of fares it currently makes available to all marketing channels, an airline will get a substantial discount on distribution costs applied to all fares sold by Orbitz. (This discount would amount to approximately 30% of the booking fees a carrier pays on bookings through Orbitz and that would presumably be incurred in booking through Travelocity or Expedia.) In addition, participating airlines have assurances that all displays will be unbiased and that each airline will retain the ownership and control of its own individual booking data, both important competitive concerns particularly for small and new entrant airlines. By making it more likely that an

airline's low fares will be found and displayed, Orbitz's superior search and display capabilities will provide further benefits to both airlines and travelers.

It is therefore not surprising that those who have the most to lose from the success of Orbitz strategy – the entrenched CRS vendors that currently dominate airline distribution and the two dominant on-line agencies – have attacked Orbitz, alleging that Orbitz will permit its major airline owners to dominate distribution by not making all fares available to all distribution channels. Upon careful analysis, however, these concerns turn out to be, at best, considerably premature and substantially overstated. More likely, they are totally lacking in merit.

To begin with, even under its own highly optimistic assumptions, Orbitz will have only a tiny share --approximately 2 percent by 2004 -- of air transportation sales, a business that will continue to be dominated for the foreseeable future by the travel agency/CRS distribution channel.¹⁸ The share of airline distribution handled by travel agencies/CRSs has increased significantly in the two decades following airline deregulation. Today, some 80% of all airline tickets are sold by travel agents who are required, as a practical matter, to utilize a CRS to make the booking. Thus, it is clear that the vast majority of travelers prefer to use the services of a travel agent to book their air travel arrangement, a situation that is unlikely to change substantially for the foreseeable future.

Figure 10: Top Reasons Consumers Don't Purchase Travel On-Line

Source: "Internet Travel", Bear Stearns, April 2000

Moreover, given the volume of inventory that each airline must sell every day, the highly perishable nature of those seats (and their associated revenues) and the fact that most flights depart with some empty seats¹⁹, no airline can afford to withhold any substantial portion of its seat inventory from any significant distribution channel. But some fares – typically for “distressed inventory”, i.e., seats that would otherwise go unsold – are priced so low as to be unprofitable if an airline were required to pay the normal commission, CRS and ARC fees. Therefore, every airline now offers so-called “e-fares”

¹⁸ Federal Register, Vol. 65 No. 142, July 24, 2000, Proposed Rules

¹⁹ The system-wide load factor for U.S. scheduled airlines in 1999 was 71 percent. Air Transport Association of America, <http://www.air-transport.org>.

that are available for purchase only on its own website.²⁰ These fares appear to constitute only 1/10 of 1 percent of all airline fares.²¹

As a result, the distribution of air travel today continues to be dominated by only four providers of computerized reservations services through whose computers the overwhelming majority of airline bookings must pass.²² Since it is typically not in the economic interest of a supplier in any industry to have distribution channels that are dominated by other parties – particularly when those parties are able to exert significant market power -- producers in a wide range of industries have traditionally used their right to control their own products as one means of countering the market power of those that distribute their products. A producer's *ability* to deny distributors access to some of its products can thus be critical to a producer's ability to control or at least seek to influence the cost and quality of its product distribution. In this fundamental respect, airlines are no different than other producers and should not be treated differently. Obviously, this is a decision each airline will make individually. Those who try this course may not succeed, but it is important that they have the opportunity to try.

Recognizing that both travelers and airlines could benefit from a new distribution alternative, Orbitz has developed a strategy that would offer comprehensive search capabilities, totally unbiased displays, and a substantial reduction in the distribution costs airlines would be required to pay. Although the approximately 30 percent discount in

²⁰ A number of airlines also use "blind" website channels, including Priceline and Hotwire, to sell their distressed inventory. Customers using these channels are not told the identity of the airline until after they have purchased their tickets.

CRS booking fees offered by Orbitz is no doubt attractive to airlines, Orbitz nonetheless expects to account for 2 percent, at most, of all airline sales – and less than one sixth of on-line ticket sales – by 2004. Thus, for most airlines, the principal attraction of Orbitz is probably its potential to provide meaningful competition to the entrenched CRS suppliers. If as a result of competition from Orbitz, other distributors (and their respective CRSs) are forced to lower their prices and/or improve their services, the savings to airlines – and ultimately to travelers – will be substantial.

ESTIMATED SAVINGS FROM REDUCED BOOKING FEES²³

30% reduction on booking fees for 2% of sales = \$12.6 million

30% reduction on 20% of sales = \$126 million

30% reduction on 50% of sales = \$315 million

If airlines are required to make all fares available to all distribution channels, however, these savings would almost certainly not be realized. Since airlines would have no way to induce their customers to use their lower cost distributor (i.e., Orbitz), other vendors and their CRS suppliers would not need to offer airlines reductions in booking fees comparable to those offered by Orbitz in order to obtain access to all fares and airlines.

Even proposals that would require airlines to provide all vendors with access to all publicly available fares only if those vendors matched the terms offered by Orbitz are replete with practical and conceptual problems. To begin with, few (if any) existing

²³ Statement of Kenneth Mead, Inspector General, USDOT, “Internet Sales of Airline Tickets”, July 20, 2000

distributors – including Travelocity and Expedia – appear to have the ability currently to provide either the comprehensive search or unbiased display provided by Orbitz. Moreover, the price matching requirement would have to focus specifically on the net cost to airlines in order to ensure, for example, that Travelocity’s CRS owner did not simply raise its booking fees enough to offset any nominal “matching” reductions promised by Travelocity, thereby eliminating the contemplated savings. In addition to involving the Department in rather detailed oversight and regulation of pricing in the distribution of air transportation, the adoption of a matching “solution” would also require the Department to ensure that other vendors fully matched the data protection and non-bias provisions offered by Orbitz. In short, the imposition of an obligation on airlines to make all fares available through all channels subject to a “matching” condition would inevitably require the Department to become involved in detailed economic regulation of the distribution sector.

If the Department were to mandate MFN without requiring other parties to fully match Orbitz’s terms, however, it would perversely affect both Orbitz and consumer welfare. Without the overall distribution cost savings inherent in the Orbitz contracts, it is unlikely that airlines would make their low e-fares available to other distribution channels since the higher cost of using those channels would make these low e-fares uneconomic. Alternatively, airlines would be unlikely to offer these e-fares through Orbitz (or any other 3rd party distribution channel) and consumers would be denied the ability to conveniently compare and then book these on the same site. And if Orbitz is denied

²² Sabre Investor Relations

²³ Source: Sabre and Galileo Investor Relations and 10-K filings

access to the low e-fares that are currently available only on individual airline's websites, it would deprive Orbitz of a key element of its strategy for attracting customers to its site and reduce significantly the likelihood Orbitz will emerge as an effective competitive spur to the incumbent firms that dominate the CRS and electronic ticket distribution sectors²⁴

Even some who could be expected to welcome the advent of effective competition to the existing CRS providers have expressed concerns based on the fact that Orbitz would be owned, at least initially, by several major airlines. I believe these concerns are misplaced. To begin with, it is becoming increasingly common in e-commerce for competitors in an industry to cooperate in the development of common platforms (or channels) for dealing with firms that supply goods and services to that industry.²⁵ More importantly, even before the recent financial difficulties encountered by so-called "dot.com" companies, investing in a new B to C e-commerce venture, particularly one seeking to compete against entrenched incumbents in the highly concentrated CRS and electronic ticket distribution sectors²⁶ was likely to be viewed by investors as, at best, a high risk undertaking. Under more recent financial market conditions, investors are likely to be even more skeptical regarding the prospects for such a venture, particularly where – as here – the dominant incumbent on-line travel agents have entered into contracts giving them exclusive rights to the most heavily used Internet portals.

²⁰ For reasons explained above including, inter alia, the strong incentives faced by airlines to sell their highly perishable seat inventories, the demonstrated consumer preference for using travel agents to book air travel, and the huge share of airline bookings handled by travel agents, airlines will continue to make the vast majority of their fares available through travel agencies as well as other distribution channels.

²⁵ Examples include Chemdex and Convisint

²⁶ I note that these incumbents have entered into exclusive access arrangements with the largest internet portals

Moreover, since the success of Orbitz strategy depends in significant part on obtaining access to all fares – something that requires the cooperation, at a minimum, of most major airlines and since these same airlines would be among the principal beneficiaries of a reduction in distribution costs, it is surely not surprising that, before putting their own capital at risk, potential investors would demand strong evidence of major airline support for Orbitz. The willingness of airlines to invest in Orbitz lends important credence to the existence of significant expected cost savings. In addition, the use of a joint venture such as Orbitz is well established as an efficient and legitimate way to share such risks. Thus, the willingness of major airlines to invest in Orbitz signals to the financial markets the support for Orbitz that is critical to attracting other investors.

If the Department were to adopt regulations that effectively kill the threat of real competition posed to the entrenched suppliers of CRS and electronic distribution services by new entrant on-line ventures, it will have effectively foreclosed the possibility of relying on market forces to discipline the cost and quality of CRS services. What will then be left is a highly-concentrated business whose dominant players enjoy significant market power, insulated from the prospect of effective competition. Under these circumstances, the Department would have to consider seriously the establishment of a considerably more comprehensive regulatory regime than the current CRS rules, one that entailed more substantial regulation of CRS fees and competitive practices.

Since under even its most optimistic of assumptions Orbitz will be only a small player in the airline distribution for many years to come, it would be far more reasonable for the Department to avoid imposing regulations that “strangle the baby in its cradle” and instead let the forces of competition play themselves out under its watchful eye. If, as is likely, the effects of competition from Orbitz and possibly other new e-distributors, prove to be beneficial and efficiency-enhancing, the Department need do nothing further. If as its opponents allege, Orbitz is used for anti-competitive purposes, the Department retains the authority to institute a rule-making or enforcement proceeding at any time. In either case, the Department will have the benefit of actual experience with competition by Orbitz and others rather than basing its decision on speculation about what might or might not happen, and how or when it might happen, in the future.²⁷

²⁷ I note that a study recently released by the International Data Corporation concluded that “Airlines will not dominate online airline ticket sales, despite the planned launch of an airline-owned Web travel venture.” See, “Airlines will not lead Web travel sales, study says”, Reuters, September 18, 2000.

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I hereby certify that on this 22nd day of September 2000, a copy of the foregoing Comments of Orbitz, L.L.C. was served by mail or by hand on the parties named below:

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